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"In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt … are defined as…limitations on the total value of service transactions or assets…" –from World Trade Organization services agreement, 1994

"We're not going to have just a set of immutable, quantitative criteria [for banks] that say if you're above this amount of assets, you're too big to fail." – Obama administration official, January 2011

Memorandum

From: Todd Tucker[1]
Date: May 10, 2011
Re: How to Reform WTO and FTA Rules to Confront Too-Big-To-Fail Banks

Summary

There are many ways that nations can check the growth of "too-big-to-fail" (TBTF) banks. One approach utilized in the past is adoption of firewalls between insurance firms, investment banks and commercial banks. This was used most famously in the United States through the Glass-Steagall Act from 1933 to 1999. But various provisions of the World Trade Organization's (WTO) General Agreement on Trade in Services (GATS) pose constraints on the type of size limitations a country may use. This is not surprising, since elimination of U.S. firewalls was a top priority for big banks in the original Uruguay Round GATS talks. Moreover, Article 13.4 of the Korea-U.S. Free Trade Agreement (FTA) contains virtually identical anti-size-limiting rules,[2] as have many bilateral FTAs since the North American Free Trade Agreement (NAFTA).

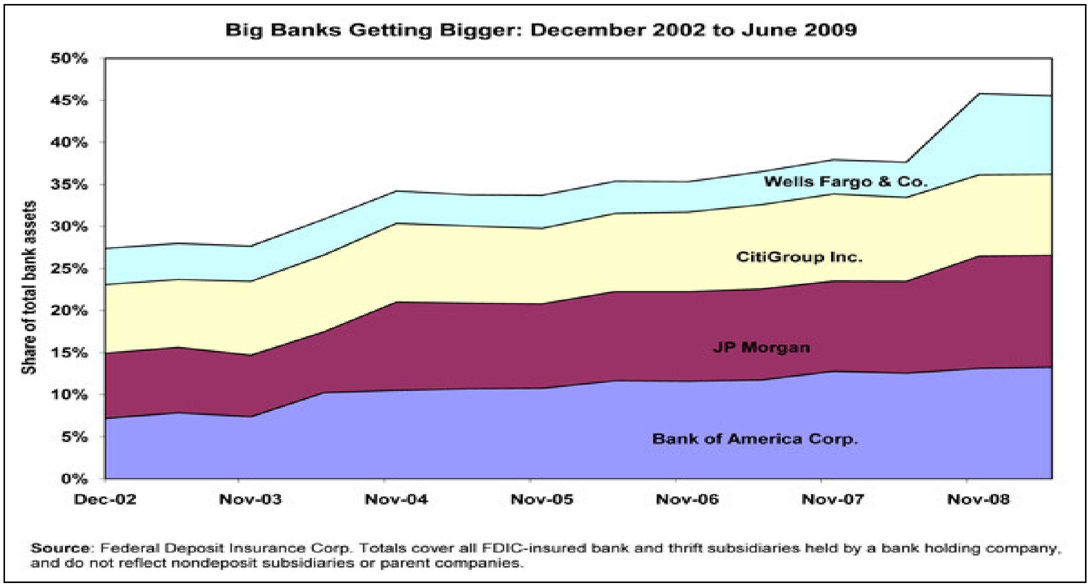
This is a technical memorandum. (For readers hoping for a more basic introduction to the GATS, go to www.TradeWatch.Org.) Section I of the current memo outlines the basic policy options and debates confronting policymakers who wish to solve the TBTF problem. Section II outlines the relevant GATS (and by implication, FTA) rules, and their possible conflict with these TBTF policy solutions – whether in the form of firewalls, licensing procedures or outright size limits. Section III concludes by suggesting a number of policy fixes.

(Appendix I examines the negotiating history of the Uruguay Round's market access rules. It also looks at the potentially Glass-Steagall-relevant provisions of the U.S. GATS schedule, and also examines records released in response to Public Citizen's requests under the Freedom of Information Act (FOIA). These documents show the disconnect between key U.S. negotiators and regulators during the Uruguay Round and subsequent financial services talks as to the reach of the core substantive obligations of the GATS. Appendix II details how the U.S. administered Glass-Steagall, which may be useful for determining the exact intersection with GATS rules.)

I. SIZE LIMITATIONS: JUSTIFICATIONS AND PRACTICE

Too Big To Fail…

In September 2009, the Economic Policy Institute (EPI) held a forum in Washington to answer the question "What to Do About Too Big To Fail?"[3] EPI's Nancy Cleeland moderated the event, and began the discussion by showing the following slide. As can be seen, the top four U.S. banks by assets doubled in size in the 2000s, growing from a little over 25 percent of all bank assets in 2002 to nearly 50 percent of assets by decade's end.



Source: Economic Policy Institute

At the event, former International Monetary Fund (IMF) chief economist Simon Johnson gave a summary of the reasons to be concerned about this phenomenon: big banks that benefit from federal deposit insurance (explicit or implicit) face a moral hazard problem that could bring down the whole economy, and big banks distort the political process and policy outcomes in favor of the wealthy. His solution? "Big banks should be sold in medium-size pieces, divided regionally or by type of business, to avoid such concentration of power." In short, "Banks that remain in private hands should also be subject to size limitations." He added that firewalls should be re-imposed, Federal Deposit Insurance Corporation (FDIC)-like resolution authorities should be strengthened, and anti-trust laws need to be modernized to complement the outright size limitations. Moreover, executive compensation and capital requirements should be structured so as to make it more costly to be big.[4]

John Boyd, a consultant for the Federal Reserve Board of Minneapolis, also expressed these concerns. He estimated that upwards of 65 percent of U.S. bank assets are held by "too big to fail" (TBTF) financial institutions. His first step in a policy fix would be to redefine virtually all financial institutions (including money market mutual funds and eBay lines of credit) as "banks," and to regulate them as such. He also advocated:

> "once banks are broadly and realistically redefined, involves setting a size threshold (which obviously would be indexed) which when exceeded will make banks fall into the TBTF category. For example, 'If you are a bank and your assets, plus the assets you guarantee, exceed a threshold (perhaps, $100 billion) you are TBTF.' Such a rule would be arbitrary, and might miss some smaller but still critical TBTF banks. Banks that become TBTF would be obliged to spin some pieces off in a timely manner. Like a constraint on the size of munitions factories, this would directly limit the risks to society at the expense of lost scale economies. In banking, however, a large empirical literature on economies of super-scale has produced mixed results. Thus, it is not obvious that a size limit of this nature would result in significant efficiency losses. We have seriously considered an alternative to the second step; to identify the TBTF banking firms according to specific operating characteristics, and then regulate them much more stringently than other banks. That would be less draconian than a size limit to be sure, but invites gaming the system. Therefore, the regulations on TBTF banks would necessarily be much more severe—given our intention to render them permanently fail-safe."[5]

… Or Too Multifunctional to Regulate?

Jan Kregel of the Levy Institute has noted several problems that contributed to the financial crisis that are connected to size matters, but not are not necessarily caused by size *per se*. Citing U.S. Supreme Court Justice Louis Brandeis, Kregel warns that *multifunctional banking,* i.e. banking that combines deposit-taking, insurance, underwriting and brokering, inherently changes the culture of banking in a way that encourages fraud and speculation, and reduces incentives to lend to the "real economy." "This argues in favor of limiting the scope of financial institutions, irrespective of size. Even China cannot provide walls sufficient to prevent osmosis across banking functions," he wrote. "Past experience suggests that multifunctional banking is the leading source of financial crisis, while large size contributes to contagion and systemic risk." He adds that:

- excessive market concentration resulting from the removal of state branching restrictions in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 is best solved by revised anti-trust mechanisms rather than outright size limitations. (Riegle-Neal also forbade the Fed from approving an application for an inter-state merger or acquisition that would result in the new institution controlling "more than 10 percent of the total amount of deposits of insured depository institutions in the United States");
- the problem of banks that are deemed "too interconnected" to fail or to resolve would be best solved by limiting multifunctional banking on the front end rather than expecting the FDIC to deal with the overly complex interconnections on the back end;
- the arguments that U.S. banks used to fight size, branching and function limits at home – that deregulation was necessary to compete with their Japanese and European counterparts – is not convincing, and that the scale economies (i.e. productivity benefits to larger size) are only valid up to the $1 billion asset mark.[6]

However, in a separate policy brief, Kregel warns that simple re-imposition of Glass-Steagall might not be enough, and that the underlying pressures that led to its unraveling would have to be addressed. By examining the primary committee materials surrounding the debate around the original 1933 act, he notes that it was designed as a stop-gap measure meant to be revisited and overhauled after the immediate Depression subsided. Major problems that the act didn't solve included the inter-state "race to the bottom" in regulatory standards, and the ongoing challenge of keeping commercial banks profitable, given the ability of nonbank institutions to provide "liquidity-creating services more cheaply than regulated banks." Indeed, Kregel argues that regulators were asleep at the wheel by allowing the emergence of institutions like money market funds and securitizers that could compete for bank deposits without being regulated like banks. While not outlining an exact legislative fix, he sees the policy options as a return to Glass-Steagall with "active monitoring and the prohibition of competitive innovations by non-regulated institutions"; to define certain money market and nonbanking institutions' activities as "banks" and regulate them as such; to "recognize the activity of deposit taking as a public service and to regulate it as a public utility, with a guaranteed return on regulated costs" because "the Constitution reserves the provision of currency to the government, and there is no reason for the major part of this obligation to be outsourced to the private sector."[7]

Financial Sector Caps as a Whole

In an article for the *New York Times,* reporters Landon Thomas and Eric Dash wrote that: "the British banking sector [is] much larger as a share of the national economy than its United States counterpart… The three largest British diversified banks — HSBC, Barclays and Royal Bank of Scotland — have assets that exceed Britain's total economic output. At the same time, the government has majority stakes in R.B.S., and Lloyd's, another large financial institution. 'This is a midsize country with an oversized bank system,' said Peter Hahn, a former investment banker at Citigroup who teaches finance at the Cass Business School in London. 'We need to figure out a scalable bank system for the taxpayer to back.'"[8] One way of dealing with the problem of a financial sector that is too large relative to the country would be to set a maximum ceiling for the ratio of financial sector product to gross domestic product. While this approach does not appear to have adherents in the current political debate,[9] it is a coherent policy option.

Summary of possible TBTF Measures

To summarize, the main policy solutions to the TBTF problem consist of:

1. Limiting the size of the financial sector as a whole.
2. Limiting the size of individual financial institutions by setting an upper limit on the number of service suppliers, total value of service transactions or assets, total number of operations or total quantity of output that any one bank can have – either through an outright quantitative ceiling or through some sort of assessment of whether a community needs such large banks. The cap can be relative (no bank can control more than 10 percent of national banking assets or GDP), or absolute (no bank can have more than $100 billion in assets). Variants of this measure are favored by the Fed's John Boyd, and are partially involved in the Riegle-Neal Act of 1994;
3. Establishment of a new public monopoly on commercial banking. This is one of the approaches suggested by Kregel;
4. Banning or restricting certain types of legal entity or financial charter (commercial banks) from offering services allowed by other entities (investment banks, etc.). This was the Glass-

Steagall approach. Alternatively, non-banks could be banned from "innovating" in ways that increase competition on insured banks. This is one of the approaches suggested by Kregel; or

5. Using other regulatory powers to make it costly to be big, such as through anti-trust mechanisms, resolution powers, or higher minimum capital requirements for larger or more complex institutions.

We'll call these **Measures 1-5,** which we will **bold** throughout the document. We take no position as to the desirability of any particular approach, but simply examine some of the implications for each approach under GATS rules.

II. RELEVANT WTO RULES

The GATS sets disciplines for over 20 distinct types of financial services (including lending, deposit-taking, and securities trading services),[10] offered in four modes of supply.[11] This section explores several GATS provisions that could limit countries' ability to deal with the TBTF problem via the five measures outlined in the previous section. We'll assume that anti-TBTF measures can either be covered by GATS Article XVI (market access), GATS Article XVII (national treatment), the prudential measures defense provision, *or* GATS Article VI (domestic regulation). We'll also examine potential overlay with provisions in the Understanding on Commitments in Financial Services (a GATS-related document) and GATS Article XVIII (Additional Commitments).

Market Access Rules and Interpretative Issues

Many commentators have suggested that anti-TBTF measures would fall under GATS Article XVI(2), which reads:

> "In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:
>
> > (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*
> > (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." [italics added]

The implications of GATS Article XVI(2) for anti-TBF measures turns on how various terms of art including within it – such as "quota" or "total" – are defined. For instance what does a "quota" mean in the GATS context? As the United States argued in the *U.S. – Gambling* case,

> "The New Shorter Oxford English Dictionary, at p. 1955, defines 'numerical' as '[o]f, pertaining to, or characteristic of a number or numbers; (of a figure, symbol, etc.) expressing a number' and, at p. 2454, defines 'quota' in relevant part as '2 The share of a total or the maximum number or quantity belonging, due, given, or permitted to an individual or group. ... b The maximum number (of immigrants or imports) allowed to enter a country within a set period; (a) regulation imposing such a restriction on entry to a country.' The term 'quota' also has a particular meaning in the context of a trade agreement. According to one treatise, '[q]uotas are numerical limitations on imports or

> exports.' Mitsuo Matsushita, Thomas J. Schoenbaum, and Petros C. Mavroidis, *The World Trade Organization: Law, Practice, and Policy*, p. 123-124 (Oxford 2003)."[12]

This suggests an understanding among trade experts and negotiators that a "quota" could be expressed as either a share of a total (i.e. ratio), or as a simple numerical cap (i.e. non-ratio)[13] – both of which could capture anti-TBTF measures. The WTO Appellate Body in the *U.S. – Gambling* case confirmed a broad reading of the term "quota":

> "Antigua contests the United States' understanding of the coverage of Article XVI:2 as limited to measures that take a certain 'form', without regard to the effects of those measures. Instead, Antigua contends that the text of Article XVI:2(a) and XVI:2(c) is intended to provide a broad description of the types of measures caught by these provisions… the absence of any definition in the GATS of the terms 'numerical quotas', 'monopolies', 'exclusive service suppliers', or 'economic needs test' supports the view that these terms cannot be used to restrict the scope of Article XVI:2 to precisely defined 'forms'… In its appeal, the United States emphasizes that none of the measures at issue states any numerical units or is in the form of quotas and that, therefore, none of those measures falls within the scope of sub-paragraph (a) or (c) of Article XVI:2. The United States contends that the Panel erred in its interpretation of sub-paragraphs (a) and (c) of Article XVI:2 by failing to give effect to certain elements of the text of these provisions, notably to key terms such as 'form' and 'numerical quotas'…
>
> "In our view, the above examination of the words of Article XVI:2(a) read in their context and in the light of the object and purpose of the GATS suggests that the words 'in the form of' do not impose the type of precisely defined constraint that the United States suggests… In these circumstances, the fact that the Wire Act, the Travel Act and the IGBA do not explicitly use numbers, or the word 'quota', in imposing their respective prohibitions, does not mean, as the United States contends, that the measures are beyond the reach of Article XVI:2(a) and (c)."[14]

There is also a debate about whether the modifier "total" in XVI(2)(b-d) could refer to policies that limit the size of *individual* institutions. According to legal scholar Markus Krajewski:

> "An important question concerns the exact meaning of the notion of 'total' in each of the three subparagraphs and whether it applies to all services and service suppliers in a given sector or to each service or service supplier individually. For example, suppose a country wishes to limit the use of water and therefore requires each user to obtain a license to use water and that each license only allow the use of a certain quantity of water per day. Arguably such a quantitative cap on water use would put a limitation on the value of service transactions of a company distributing water to households. However, could such a limitation be seen as a 'limitation on the *total* value of service transactions' according to Article XVI:2(b) or would only an abstract limitation of the total value for the entire territory (or regional subdivision) constitute such a limitation?"

Krajewski argues that, while it would seem that subparagraphs (b) and (c) do not refer to the size limits of individual firms, "an understanding" would need to be adopted to that effect to avoid any ambiguity.[15] Petros Mavroidis (formerly of the WTO's legal division and cited by USTR as an authoritative source in a quote above) also raises the possibility of subparagraphs (b) and (c) applying at the level of the individual firm, citing an example from Taiwan's schedule.[16]

The U.S. Trade Representative's Office has nonetheless argued that these requirements "refer to sector-wide limitations (that is, all institutions in a country), not limitations on individual institutions."[17] It is unclear how meaningful this distinction is in practice. For instance, a specific regulatory action that keeps an individual bank from exceeding a certain size is simply an application of a generalized rule that "all institutions in a country" be below a certain size. A rule that only a single or a single foreign institution not exceed a certain size, even when other institutions are allowed to exceed that size, would be an instance of a discrimination issue, not a market access issue. Moreover, the WTO panel in the *US – Gambling* case noted that the modifier "total" will be without meaning in certain instances.[18]

There are several possible GATS market access conflicts with **Measures 1-5**. In the coming pages, we'll examine each measure in kind.

GATS Market Access Rules: possible conflicts with size limitations

USTR has disputed that firewalls could be a basis of GATS concern. Indeed, when asked whether the provisions were at least vague, USTR asserted "the obligations in the financial services chapter do not prevent government actions to address systemically important financial institutions, create 'firewalls' among sector-specific financial services suppliers, or otherwise regulate financial products…We don't need to clarify this part of the agreement… We understand, and our trading partners understand, how the agreement operates as a whole. We don't think it's necessary to do anything different here."[19]

But USTR's claim of a shared understanding does not seem to have much support. For instance, the limitations inscribed in actual GATS schedules provide an indispensable "context" for interpreting the GATS obligations. Indeed, the presence of these inscriptions in other member's schedules is highly relevant for any interpretation of the U.S. schedule, as USTR itself has argued in the WTO's *U.S. – Gambling* case.[20]

Many of the countries that list size limitations and firewalls are also the countries that U.S. negotiators most pushed to make deeper commitments through nearly a decade of "shuttle diplomacy" by high ranking officials like Tim Geithner and Larry Summers. U.S. negotiators were paying close attention to the GATS offers made by Asian and European economies. It seems unlikely that U.S. officials would have stood by while these top trading partners made simply frivolous limitation entries in their GATS schedules over nearly a decade of work. This suggests a common understanding among negotiators that certain types of firewalls could indeed violate GATS market access commitments.

GATS Market Access Rules and Asset or Output Caps

Variants of **Measure 1** could conflict with Article XVI(2)(b) if expressed in terms of an upper limit on the total transactions or assets that the financial sector as whole could have. **Measure 1** could conflict with Article XVI(2)(c) if expressed in terms of an upper limit on operations or output. As noted earlier, this policy does not appear to have many proponents, and no finance/GDP target is set out as a limitation to any of the GATS schedules.[21]

Measure 2 has a slightly different implication *vis a vis* GATS rules, depending on the form the limitation takes. Comparable to the Measure 1 analysis, there can be absolute individual service supplier size limitations – a cap of $100 billion in assets or output per bank. Or there can be relative size cap, like a cap of 10 percent of total nationwide assets per bank.

The July 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act will expand the old Riegle-Neal rules, so that there can be no authorization for a bank merger that leads to a bank controlling more than 10 percent of total nationwide liabilities of the financial sector. While the United States did not schedule Riegle-Neal's deposit limitation as an exception to its market access commitments, the WTO Secretariat described this as a "size limitation" in its most recent Trade Policy Review.[22] Indeed, it could be seen as a form of quota, applied to all banks, which in specific instances will result in denial of authority for a bank to grow bigger.

GATS schedules have several instances of this type of limitation. India's market access commitment for banking states: "A limit of twelve licences per year both for new entrants and existing banks." Oman's market access commitment for banking states: "Number of bank branches in Muscat limited to four for each bank (whether local or foreign)." Both are non-discriminatory ceilings on the number of operations, by service supplier. In other words, despite the presence of the word "total" in GATS Articles XVI(2)(b-c), WTO members scheduled transaction/ asset/ operation/ output caps on a per service supplier basis.

GATS Market Access Rules and Caps of One (Monopoly) or Higher

Any variant of the tools listed in **Measures 3 and 4 –** while not a straightforward size limitation in the sense of Measures 1 and 2 – could also run afoul of the GATS Article XVI(2).

Measure 3 would clearly run afoul of Article XVI(2)(a), since it would constitute a new public monopoly over commercial banking and thus "limit the number of service suppliers" (to one). The Secretariat reiterated in February 2010 that new public monopolies in scheduled financial services would be subject to GATS terms and thus WTO dispute settlement.[23]

There are several dozen listings of monopolies in the GATS schedules. Albania's schedule states that, "Settlements and clearing services for the time being are offered by the BOA only." Armenia's schedule states that, "Settlement and clearing services of securities and derivative products are reserved exclusively to the Central Depositary Service of Armenia." Australia's schedule states that "Comcare is the monopoly provider of workers' compensation insurance to Commonwealth Government employees."

There are also examples of numerical caps on service suppliers on a country-wide basis. Malaysia limits its reinsurance market access commitment by stating, "Seven new licences for non-life reinsurance business within 10 years ending 30 June 2005." Singapore's schedule states that there will "no new finance companies." Uruguay, in various financial sector subsectors, lists this limitation, "For banks, commercial presence is subject to the following quantitative limit: in any one year, the number of authorizations for new banks to operate may not exceed 10 percent of the number in the year immediately preceding. This provision applies exclusively to those institutions which are defined by the law as banks and does not affect other financial intermediation enterprises."

GATS Market Access Rules and Quotas of Zero (Bans)

Under the Market Access rules, a country may not ban a highly risky financial service in a sector (i.e. banking, insurance, or other financial services) that it has bound to the GATS, even if that policy applies to domestic and foreign firms alike.[24] Consequently, there are a number of **Measure 4-type** non-discriminatory bans listed as limitations on market access commitments. For instance, the Korean schedule states, "Real estate trust business is prohibited." The U.S. schedule states, "Federal law prohibits the offer or sale of futures contracts on onions, options contracts on onions, and options on futures contracts on onions in the United States, and services related thereto." Venezuela's schedule states, "The operation of companies known as tontines or 'chatelusianas' or a combined form of the two is prohibited."

These examples are bans on types of services per se. But firewalls – which prohibit certain types of entities from offering certain types of services – could also be seen as GATS prohibited bans. In other words, the ban would be on a certain "slice" of a service sector.

WTO jurisprudence has rules that bans – even on slices of services sectors – are prohibited by GATS market access rules. In the *U.S.-Gambling* case, the WTO Appellate Body ruled that – even when a service is not itself banned, or even banned through a particular mode of supply – a ban on a particular *means* of supply in a given mode can be violative of a country's XVI(2) obligations. (In this case, gambling was allowed, and even cross-border gambling was allowed, but cross-border gambling via the Internet was alleged to be not allowed.)[25] Thus, another country could argue that banning securities firms from providing commercial banking constitutes a ban on a particular means of supplying a service. In a recent attack on China's financial services policies, USTR appears to accept the logic that a cap on a slice of a mode of a sector can still be a GATS prohibited market access violation.[26]

As it happens, strict firewalls (i.e. bans on blends and slices) abound in GATS schedules. Jordan's schedule states, "only Banks may undertake activities involving the acceptance of deposits and other repayable funds from the public." Macedonia's schedule states that deposit-taking "May be provided by banks and saving houses only. Saving houses are authorized to provide deposit services for natural persons only." The Philippines' schedule states that trading services "Must be performed by an investment company." Italy's inscription in the European Communities schedule states that, "From 1 January 1993 foreign as well as domestic banks may not provide securities dealing for its own account or for the account of customers; however, banks, including branches of foreign banks, are allowed to deal in Treasury bonds and State-backed securities."

Of course, as Appendix II notes, past firewalls were not typically strict bans, and contained loopholes. There are examples of these in GATS schedules too. Cyprus' schedule states "Banks and Insurance companies may not undertake brokerage business. However their subsidiary brokerage firms may do so." Israel's schedule states: "Banks are required to carry out asset management activities only through subsidiaries." This closely mirrors a set of proposals that the UK is currently considering.[27]

(Note that firewalls are often enforced through authorization and examination procedures, rather than "bans," quotas or economic needs tests. According to the GATS Scheduling Guidelines, in instances where "the granting of licences is subject to review" under a country's schedule, this would mean "they are granted on a discretionary basis. In such a case the right to supply the service is unbound."[28] Indeed, while licenses are traditionally thought to fall under GATS Article VI and/or Annex Article 2(a) – explored below – the GATS Scheduling Guidelines make it clear that discretionary licensing itself can be a form of violation of countries' market access commitments if not scheduled.)

Legal Entity Restrictions

A variant of **Measure 4** that required a particular type of legal entity to provide commercial banking services could run afoul of Article XVI(2)(e). Would a commercial banking charter qualify as type of legal entity requirement? Returning to Krajewski: "The term 'type of legal entity' presupposes a typology of legal entities, but it does not specify whether such a typology must be based on provisions of commercial company code or whether is can also be based on an otherwise recognizable typology. In light of the differences among the legal systems of WTO members, it is difficult to assume that only legal types recognized on the basis of statutory company law should be regarded as legal types." Krajewski goes on to write that "non-profit organization" might be considered a "legal type" or a "qualification."[29] Thus, absent a revision to the GATS terms to clarify that legal types only refer to the distinction between, e.g., subsidiaries and branches, firewalls enforced through charter requirements remain vulnerable to attack.

GATS schedules have examples of limitation that could easily pertain to the range of typologies of legal entity. For instance, Bahrain's schedule states that "No banking activities to be undertaken by a limited liability company." Brazil's schedule states that, for freight insurance services, "The formation of a specific type of legal entity is required, in the form of a Sociedade Anônima, with registered stocks." And the preceding section noted a series of firewall limitations that were scheduled by line of business, if line of business were to be considered an acceptable typological distinction within the notion of "legal entity."

GATS Market Access Rules and Discretionary Licensing Procedures

There is also the possibility that **Measures 2 or 4** could be considered an "economic needs test" (ENT) subject to Article XVI(2) disciplines. In a 2001 study, the WTO Secretariat noted:

- "The term 'economic needs test' is not defined in the GATS. Nor does the term have a well-defined meaning in standard dictionaries or in the economic literature."

- "The context of Article XVI would suggest a broad reading of the words 'economic needs', and that ENTs be regarded above all as 'tests' that condition market access."
- "ENTs are one of the 'forms' through which quantitative limitations of the types listed in sub-paragraphs (a) to (d) of Article XVI:2 may be implemented by a Member. A measure is not therefore an ENT needing to be scheduled if it is not a 'form' of one of the types of quantitative measure mentioned in those sub-paragraphs. In particular, a 'test' that is not quantitative in nature, but relates to the quality of the service, or on the ability to supply the service, would not be considered an ENT and should not be scheduled as a market access measure under Article XVI. This is so even though the measure, relating to the quality of the service or the ability to supply the service, incidentally results in fewer service suppliers in that sector than might otherwise be the case."[30]

Moreover, the WTO Appellate Body has confirmed that there is no strict limitation on the types of measures that could be considered an ENT:

> "We further observe that it is not clear that 'limitations on the number of service suppliers ... in the form of ... the requirements of an economic needs test' must take a particular 'form.' Thus, this fourth type of limitation, too, suggests that the words 'in the form of' must not be interpreted as prescribing a rigid mechanical formula."[31]

In other words, ENTs are not defined, and the WTO's own staff advocate for a "broad reading" of the term. Thus, it is perhaps not at all surprising that many developed and developing country members scheduled a total of 36 limitations that they consider to be ENTs. Among the limitations on Mode 3 market access [emphases in original]:

- Canada: "(only for *Ontario, New Brunswick and Nova Scotia):* Incorporation or registration will be <u>refused unless authorities are satisfied that there exists a public benefit and advantage for an additional corporation</u>." In other words, Canada felt that the fact that provincial approval procedures at either the incorporation *or* registration stage might be considered an ENT or market access limitation.
- Chile: "In addition to the horizontal measures in Section I of Chile's Schedule of Commitments which affect all sectors, a supplier of financial services operating through a commercial presence <u>may be subject to evidence of economic need.</u> That is, he must obtain prior authorization to start up, suspend or terminate operations from the Banking and Financial Institutions Supervision Department (SBIF), in the case of banking services, or from the Securities and Insurance Supervision Department, in the case of securities and insurance services. Authorization to supply financial services through a commercial presence will be given in so far as the applicant undertakes to ensure the proper functioning, integrity and stability of the market, fulfils the requirements of the law and serves the national interest. In addition, there may be non-discriminatory restrictions or provisions regarding the type of commercial presence that must be adopted by firms operating in the securities or insurance sectors in Chile." In other words, Chilean authorization procedures at the start-up or wind-down phase are interpreted by Chile (as indicated by the clause "That is") as amounting to an economic needs test.
- Cyprus: "For new banks the following requirements apply: "(a) a licence is required from the Central Bank for the carrying out of banking business. The Central Bank in granting a licence

may apply an economic needs test." Cypriot authorities consider ENT to be a *component* of a licensing procedure, rather than equating the two. However, the first sentence indicates that the requirement to have a license is considered by Cyprus to be a potential market access violation requiring the scheduling of a limitation.

- Honduras: "The establishment of financial institutions is subject to approval by the Central Bank of Honduras following a recommendation by the National Banking and Insurance Commission in accordance with the economic conditions and needs of Honduras. This approval will take into consideration, inter alia, a market survey showing that under present and future conditions of supply and demand for financial services the market has room for the entry of a new institution. The foregoing must be based on an analysis of the principal economic and financial variables contained in the national accounts, statistics and basic indicators of the real and financial sectors of the domestic economy, without prejudice to the submission and explanation of theoretical models that reasonably provide such a demonstration." This is perhaps the most detailed description of the conditions of a financial services ENT of any WTO member. It notes several criteria that banking authorities will take into account when conducting an approval procedure – "*among other things*." Might then the capital requirements or compliance with Glass-Steagall firewalls that the Comptroller and Federal Reserve took into account when chartering a corporation with authorization to engage in commercial banking (see appendix below) be a market access restriction? Apparently some WTO members thought that the exact scope of GATS Article XVI was vague enough that their similar measures might be subject to scheduling as market access restrictions.
- Kingdom of the Netherlands with respect to Aruba: "Off-shore companies cannot operate on the domestic market. A test of economic needs is applied for the establishment of branches and subsidiaries on the domestic market (incl. expansion of activities of established banks through new branches)." In most tax-haven jurisdictions, the distinction between "on-shore" and "off-shore" banks has to do with the type of license or charter an entity possesses, what type of client they do business with, and what type of taxation that client is subject to. In other words, even a developed country like the Netherlands thought that Aruba's (for whom it negotiates) line-of-business typologies could be considered a market access limitation or ENT subject to scheduling.
- Uruguay: "Any supplier of financial services wishing to engage in operations in Uruguay may not do so without prior authorization from the competent authorities. The application may be rejected on precautionary grounds, including the current state of the market." Here, just another instance where a WTO member thought that its precautionary, prudential measure might be a market access violation.

Here are just six examples (there are more) of WTO members disagreeing with the contention that prudential, precautionary and "line-of-business distinction" measures prior to, during and after a licensing procedure could constitute violations of Article XVI(2)… and not Article VI or Annex 2(a) measures.

U.S. Bilateral Pacts Show Market Access Could Apply to Limits Experienced by Individual Firms and Line of Business Distinctions

The U.S. has a series of implemented and proposed bilateral trade agreements that include financial services chapters. These chapters differ in structure from the GATS, but include many of the same disciplines, such as market access. While the GATS is a positive list agreement (meaning service sectors aren't disciplined unless listed), FTAs are typically negative list (all sectors disciplined unless specifically carved out in a special Annex III to each of the FTA).

The possibility of carving out policies in an FTA's Annex III from market access disciplines helps elucidate the content of the market access requirement itself. For instance, if USTR agreed that policies affecting individual firms had to be listed as a market access carve-out to be maintained, then that suggests that USTR believes that such policies would otherwise violate the market access requirement.

As it turns out, the Annex III in several U.S. FTAs contain a host of individual service supplier-related maximum quantitative limits. Annex III to the U.S.-Korea FTA notes that "The United States undertakes no commitment with respect to Article 13.4(b) in relation to the expansion, via the establishment of a branch or the acquisition of one or more branches of a bank without acquisition of the entire bank, by a foreign bank into another state from its 'home state,' as that term is defined under applicable law. Except as provided elsewhere in this schedule, such expansion shall be accorded on a national treatment basis in accordance with headnote 2(a)." (Annex 13.4(b) bans limitations on "the total value of financial service transactions or assets…") This limitation is not expressed as a ceiling on the total assets in the U.S. banking system, but a regulatory device that applies to individual banks on a bank-by-bank basis. (USTR listed a similar carve-out in other FTAs.)

In the U.S.-Korea FTA, Korea felt the need to list a policy limiting the "overbought (long won) position of NDFs (Non-Deliverable Forwards) held by onshore banks may not exceed 110 percent of the position registered on January 14, 2004." In other words, an asset/liability ratio calculated on an individual bank basis could constitute a market access violation if not scheduled. Also, Guatemala lists the capital/asset ratios than individual foreign bank branches must meet as a carve-out from CAFTA's market access rules.

Various U.S. FTAs also have market access carve-outs for line-of-business separations. Chile took a carve-out from FTA market access rules that allow it to separate its insurance market into companies that can insure property versus those that can issue life and other insurance. Singapore took a carve-out from FTA market access rules that specify that wholesale banks and so-called "offshore banks" within Singapore cannot engage in certain activities, such as offer of savings accounts or small deposit services.

In sum, in the negotiations in which USTR was most intimately involved, they agreed that certain policies affecting individual institutions or line-of-business distinctions could fall afoul of GATS market access rules.

Possible National Treatment Conflicts with TBTF Measures

GATS Article XVII establishes that countries that take commitments under it must "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…. 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."

While it seems unlikely that **Measures 1-5** would fall afoul of this rule, it could be argued that even a formally non-discriminatory firewall could modify "the conditions of competition" in favor of domestic firms. Take Glass-Steagall. Although both U.S. and European banks had to comply with the firewall when it was in effect, it could be argued to place a special burden on European banks who combined both commercial and investment banking back in their home markets. Accordingly, a lot of time in the Uruguay Round was spent trying to craft language (either under the market access, national treatment, or both articles) that would address the European multifunctional banks' concerns.

Foreign banks even complained that the authorization procedures under the Gramm-Leach-Bliley Act (which repealed Glass-Steagall and allowed financial holding companies to hold banks, brokers and insurers) was discriminatory towards them. Draft regulations under the former act required a foreign bank to maintain a three percent Tier 1 capital/assets ratio. As reported by the *American Banker* magazine, "European bankers argue that such a leverage requirement is unfair to their banks, which tend to hold lower-risk assets than U.S. banks and therefore hold less capital… 'We think comparability can be achieved, particularly with regard to capital, by using the internationally agreed upon standards of the Basel Committee, and not a U.S.-specific test that these banks have never had to work with,' Mr. [Lawrence Uhlick of the Institute for International Bankers] said." The foreign banks also maintained that authorization takes longer for them, to which U.S. Federal Reserve Board Governor Laurence Meyer responded that "13 of the 15 foreign bank applications have been approved. Two were withdrawn for reasons unrelated to capital or management issues, he said. Several U.S. institutions have had their applications rejected outright, Mr. Meyer added. 'U.S. banks do not receive an automatic pass through the financial holding company process.'"[32]

This exchange brings up several points of relevance to the intersection between GATS and banking regulation. First, even formally non-discriminatory domestic regulations like minimum capital requirements that are not Article XVI(2)-prohibited measures can be cited for modifying the conditions of competition in a way that could fall afoul of Article XVII, or be seen as more trade restrictive than necessary under Article VI (explored below). Second, the authorization procedure described by Meyer seems to suggest some regulatory discretion that might constitute an Article XVI(2) prohibited "discretionary licensing" procedure or economic needs test.

GATS Exception for Public Order

If a firewall violated a country's commitments under Article XVI or XVII, the country could invoke the GATS exceptions in Article XIV, which reads in relevant part: "Subject 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 by any Member of measures:… necessary to protect public morals or to maintain public order…"

Successful defense under this Article is no simple task, and perhaps even less so for an anti-TBTF measure like Glass-Steagall. Based on past jurisprudence from the *U.S.-Gambling* case, the respondent country would have to show that Glass-Steagall was a measure "designed" to maintain public order, and then whether it was "necessary" to maintain public order. As the Appellate Body wrote in that case, "The process [of establishing necessity] begins with an assessment of the 'relative importance' of the interests or values furthered by the challenged measure. Having ascertained the importance of the particular interests at stake, a panel should then turn to the other factors that are to be 'weighed and balanced'. The Appellate Body has pointed to two factors that, in most cases, will be relevant to a panel's determination of the 'necessity' of a measure, although not necessarily exhaustive of factors that might be considered. One factor is the contribution of the measure to the realization of the ends pursued by it; the other factor is the restrictive impact of the measure on international commerce…. It is on the basis of this 'weighing and balancing' and comparison of measures, taking into account the interests or values at stake, that a panel determines whether a measure is 'necessary' or, alternatively, whether another, WTO-consistent measure is 'reasonably available'. The requirement, under Article XIV(a), that a measure be 'necessary' – a that is, that there be no 'reasonably available', WTO-consistent alternative—reflects the shared understanding of Members that substantive GATS obligations should not be deviated from lightly."[33]

It seems unlikely that Glass-Steagall – if deemed violative of Article XVI or XVII – would pass these hurdles. Indeed, a complainant country would have to go little further than showing that Europe's non-firewall regulations are a "reasonably available," presumably more "WTO-consistent alternative."

But, assuming that the firewall could pass the necessity test, it would then be subject to the requirement of the first part of the Article XIV, the so-called chapeau. As the Appellate Body wrote in *U.S.-Gambling,* "The focus of the chapeau, by its express terms, is on the application of a measure already found by the Panel to be inconsistent with one of the obligations under the GATS but falling within one of the paragraphs of Article XIV. By requiring that the measure be applied in a manner that does not to constitute 'arbitrary' or 'unjustifiable' discrimination, or a 'disguised restriction on trade in services', the chapeau serves to ensure that Members' rights to avail themselves of exceptions are exercised reasonably, so as not to frustrate the rights accorded other Members by the substantive rules of the GATS."[34] Again, given that Europe had long argued that firewalls restrict their banks' commercial opportunities in the U.S. market, and that the U.S. ultimately removed its carve-out of Glass-Steagall (see Appendix I of this memo), it seems that a complainant country could make a strong case that reimposition of an abandoned GATS-conflicting policy would not pass some aspect of the chapeau.

(One caveat: since the *U.S.-Gambling* case doesn't represent binding precedent, it would be hard to know with certainty how a WTO dispute panel or the Appellate Body would consider an Article XIV defense for a firewall.)

Implications of anti-TBTF Rules under GATS Article VI

Measure 5 type policies would likely be addressed in other sections of the GATS. This family of policies **–** i.e. anti-TBTF policies not expressed as strict ceilings or firewalls – could be argued to fall outside of GATS Articles XVI (Market Access) or XVII (National Treatment).

GATS Article VI on Domestic Regulation applies to policies not covered by Article XVI or XVII.[35] The most important provision here is Article VI(4), which creates a mandate for the WTO's Council for Trade in Services to establish further GATS rules to ensure that domestic regulations "do not constitute unnecessary barriers to trade in services," are "not more burdensome that necessary to ensure the quality of the service, and "in the case of licensing procedures, not in themselves a restriction on the supply of a service." Key terms in this article (restriction, necessary, objective, burdensome) are left undefined, meaning that WTO panels would be permitted to interpret them if and when final disciplines for this sector are developed. The Council's Working Party on Domestic Regulations is currently doing so, and many scholars have presented serious concerns about these and other terms which are left undefined in the draft.[36] (In the interim, countries may bring disputes under Article VI(5), which references the Article VI(4) requirements, and requires countries to show "nullification and impairment." As legal scholar Panagiotis Delimatsis has argued, doing so would be very difficult, and no such case has yet been brought under the GATS.[37])

Note the reappearance of the "necessity test." This is troublesome, for many of the same reasons that the necessity test in Article XIV is troublesome. For instance, a defendant country would likely have to show that a **Measure 5** was not overly trade restrictive, or that there weren't a reasonably available alternative.[38] As this memo shows, there are always alternative measures available, and other countries may employ regulations that they see as less restrictive than tougher anti-TBTF measures.

In fact, the very basis for the GATS challenge would likely be that the anti-TBTF measure was making problems for banks used to lighter regulations in other jurisdictions, as the Lawrence Uhlick quote on minimum capital requirements above indicates. (Even if the full-blown necessity test doesn't make it into the WPDR's final domestic regulation disciplines, even lesser standards – such as the requirement in some of the draft negotiating text that regulations be "pre-established" – could pose problems for countries' ability to institute new anti-TBTF measures.[39])

Debating the intersection between GATS Annex on Financial Services and other GATS rules

The GATS Annex on Financial Services also has a provision entitled "Domestic Regulation." It reads:

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

What is the interrelationship between Articles XVI, XVII, VI and Annex 2(a)? The GATS Scheduling Guidelines specify that:

> "Minimum requirements such as those common to licensing criteria (e.g. minimum capital requirements for the establishment of a corporate entity) do not fall within the scope of Article XVI. If such a measure is discriminatory within the meaning of Article XVII and, if it cannot be justified as an exception, it should be scheduled as a limitation on national treatment. If such a measure is non-discriminatory, it is subject to the disciplines of Article VI:5. Where such a measure does not conform to these disciplines, and if it cannot be justified as an exception, it must be brought into conformity with Article VI:5 and cannot be scheduled."[40]

Here, the Secretariat notes that minimum capital requirements can be viewed as discriminatory under Article XVII. It also notes that, while measures under Article XVI and XVII can at least be scheduled to avoid having to eliminate them, measures that violate the criteria of Article VI (trade restrictiveness, etc.) have to simply be brought into conformity. Any uncertainty about the line between these measures would be determined by a WTO panel in the event of a challenge. (Also, it's important to bear in mind that the Secretariat's claim that "minimum requirements" never fall under Article XVI has to be tempered by the Secretariat's claim elsewhere that "discretionary licensing procedures" can fall under Article XVI.)

A 1998 WTO Secretariat paper on financial services also addressed the interrelationship between Articles XVI, XVII, VI and Annex 2(a), suggesting that they refer to mutually exclusive categories of measures:

> "[There are] four types of government intervention or involvement that could have an impact on the financial services sector, which were (i) macroeconomic policy management, (ii) prudential regulations, (iii) non-prudential regulation to pursue various public policy objectives other than that falling under (iv), and (iv) trade restrictions concerning market access or national treatment. Under the GATS, item (ii) is dealt with by paragraph 2 of the Annex on Financial Services, and (iii) by Article VI. Item (iv) is dealt with by Articles XVI and XVII."[41]

In other words, the prudential measures defense (PMD) is a *lex specialis* applying to domestic measures that don't fall under Articles XVI, XVII or VI.[42] But the word "prudential" is not defined, as the Secretariat goes on to note:

> "There would be little objection to considering that, in banking, for example, capital adequacy ratios, limits on risk concentration and risk management system requirements, liquidity requirements, prohibitions on insider trading and transactions giving rise to conflicts of interest, rules on the classification of and provisioning for non-performing assets, 'fit and proper' tests for directors and managers, as well as transparency and disclosure requirements constitute prudential measures. At the margins, however, *there may be differences of views as to whether certain measures can be considered as prudential, and therefore, not subject to scheduling under the GATS*.
>
> "[Footnote: Traditional line-of-business restrictions, such as the segregation of banking, securities and insurance businesses such as those existing in the U.S. and Japan, have prudential objectives, but they *can be perceived as having non-prudential elements* from the point of view of European countries with a tradition of universal banking. Another example may be portfolio allocation rules for investments of financial institutions, where a shift appears to be occurring towards the adoption of prudent-person rules providing flexibility in investment decisions instead of numerical restrictions traditionally adopted in many European countries. This does not *necessarily* mean, however, that the traditional rules are trade restrictions limiting market access or national treatment.]"[43] [italics added]

It is worth noting from the above quote that the Secretariat was given an opportunity to definitively state that "traditional line-of-business restrictions" could not be challenged under the GATS Articles XVI or XVII. The Secretariat chose not to state this, instead noting that Europeans may not view firewalls as prudential measures and could presumably then challenge them under the GATS. The Secretariat goes on:

> "Non-prudential regulatory measures such as lending requirements to certain sectors or geographical regions, restrictions on interest rates or fees and commissions, and requirements to provide certain services may also exist. Services related to the issuance of public debt are often subject to special rules and standards. *Some of those measures may be subject to scheduling under the GATS as limitations on market access*, or as limitations on national treatment, particularly when they are applied in a discriminatory manner…
>
> "Financial regulators have been generally cautious towards introducing competition in the financial sector, due primarily to prudential concerns, but also because many countries have adopted policies to develop domestic financial industries and markets. *Based on those concerns, licensing and authorization requirements in financial services are often restrictive, and the conditions or requirements sometimes extend beyond prudential objectives such as soundness and competence of applicants. This appears to be the reason why many of the licensing requirements or restrictions on the number of licenses granted were inscribed in the Schedules of Members as limitations on market*

> *access and national treatment*. [Footnote: It is again noted that the Understanding (paragraph B.6.) explicitly allows a Member adopting it to impose terms, conditions and procedures for authorization of the establishment and expansion of a commercial presence.] As such licensing requirements are liberalized and *are made purely prudential, they may no longer need to be scheduled as trade restrictions, but there may still be an issue of whether they constitute unnecessary barriers to trade in financial services*. [Footnote: Although technically, Article VI:4 and 5 *may not* be applicable to prudential measures, questions may remain as to whether they are based on objective and transparent criteria, or are not more burdensome than necessary."[44]] [italics added]

Again, as before, the Secretariat gave itself a chance to state that measures considered prudential by national regulators would not be subject to GATS Articles XVI, XVII or VI attack. Instead, it notes that some domestic regulations may be in fact market access barriers; that financial services *licensing* procedures can and have been considered market access violations; that licensing procedures may not be "purely prudential;" and in any case could violate Article VI disciplines on the trade restrictiveness of domestic regulations.

In a more recent paper from 2010, the WTO Secretariat is no more definitive on the questions of whether anti-TBTF measures could be considered market access restrictions (falling under Article XVI) or violations of other GATS domestic regulation requirements. Several aspects of the 2010 paper merit note:

- It completely dodges the question raised by Krajewski, Mavroidis and Public Citizen of whether size limitations apply to individual firms (i.e. **Measure 2**), even though this has long been a concern.
- As noted in the above section on market access, it explicitly makes clear that new monopolies in financial services (i.e. **Measure 3**) could be constrained by the GATS.
- Moreover, the Secretariat also appears to dismiss firewalls as a useful regulatory device. The Secretariat oddly excludes the removal of New Deal-era firewalls as a contributing root cause to the crisis, but then adds patronizingly that such "regulatory initiatives seem genuinely motivated by the need to avoid systemic risk"[45]
- In fact, the Secretariat appears to suggest that new firewalls (i.e. **Measure 4**) could indeed violate GATS commitments: after discussing the possible interest by member countries in such policy tools, the Secretariat worryingly notes that "even if any specific measure could be considered as inconsistent with an obligation or commitment in the GATS," a country facing a WTO challenge could invoke in its defense before a WTO tribunal an alleged exception related to prudential measures.[46] In other words, such measures could constitute *prima facie* GATS violations.
- Finally, of relevance to **Measure 5.** Sources cited in the 2010 paper also suggested a theory of the way that Article VI and the PMD interact. For instance, one source cited in the paper, the Canadian government official Eric Leroux, argued "It should be noted that to the extent that there is no conflict between the prudential carve-out and Article VI of the GATS, which also relates to domestic regulation, the provisions of the latter apply." And former U.S. official Sydney Key wrote that (and the WTO quoted) "the prudential carve-out overrides the requirements for domestic regulations in Article VI of the GATS." Yet the ramifications of these theories are not further addressed by the paper.[47] Thus, if **Measure 5** policies – which

would not typically fall under Article XVI or XVII – fall within the kosher "prudential" frame, then they would appear to be granted more protection than under Article VI. Indeed, Article VI may not even apply to such measures. But if an anti-TBTF measure were deemed "non-prudential," it would likely not fall under the PMD, and may have to be defended under Article VI.

Prudential Measure Defense Applicable to Anti-TBTF Policies?

In the penultimate quote above, the WTO suggests that the PMD could be used to defend against an Article XVI-violative policy. But it would seem that such measures are either definitionally "non-prudential" in the GATS context, or alternatively, if "prudential", unable to use the PMD. (For interested readers, we discuss this conundrum in more detail elsewhere.[48])

During the Uruguay Round, negotiators tasked with drafting the early versions of the PMD seemed intent on limiting its use for market access violations. For instance, on March 30, 1990, current Treasury Secretary Timothy Geithner circulated his team's proposal for a PMD, which read: "Article 10: Financial Regulation: 10.1 Nothing in this agreement shall prevent a Party from taking reasonable actions necessary for prudential reasons or for the protection of investors, depositors, or others to whom a fiduciary or other duty is owed by a financial services provider. 10.1.1 However, such actions shall not prevent the establishment by a financial service provider of another Party of an enterprise for the provision of financial services on conditions which accord national treatment..." In other words, "regulate" but don't prevent market access.

In June 1990, European negotiators insisted that measures taken under any PMD must "be compatible, not only with provisions on national treatment but also with any other provision of the agreement including market access, transparency, and most-favoured-nation treatment."[49] In other words, again, "regulate" but don't prevent market access.

Likewise, in October 1990, developed country negotiators were working off of a version of a PMD that specified that such regulations "shall be exercised in a manner consistent with the obligations assumed by a party under" the GATS.[50] The working version of the PMD from June 1991 stated that these measures "shall not be applied in a manner which would constitute a means of arbitrary or unjustifiable a) restriction on the provision of a financial service providers of another Party…" The final version of the PMD, dating from December 1991, dropped the "arbitrary or unjustifiable" requirement, and simply stated that prudential measures "*shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement*." A member's "commitments" of course, include the requirement to not institute many if not all anti-TBTF measures.

Subsequent negotiating materials also bear out the distinction between "prudential" on the one hand and "Article XVI-violative" on the other. For instance, the March 1992 U.S. offer on financial services stated "future and existing prudential measures do not constitute restrictions on market access or national treatment and are thus not schedule as such." Much later, U.S. negotiators worked very hard to get China to commit to wide ranging GATS commitments as part of its 2001 accession to the WTO. China's schedule also bifurcates between "prudential" and XVI-violative: "Criteria for authorization to deal in China's financial industry are solely prudential (i.e., contain no economic needs test or quantitative limits on licenses)."

In sum, the PMD would seem to only offer protection for policies that are both deemed by a WTO panel to be "prudential" and that also do not violate Articles XVI or XVII. This may offer somewhat more protection than the scrutiny of GATS Article VI, but is still troublesome, especially given the tendency of many regulators to define "prudential" in narrow ways that embody more "light touch" regulation.

In summary, the Secretariat has refused multiple opportunities to state that **Measures 2, 4 and 5** are allowed under the GATS. To the contrary, the possibility has been left open that such policies could fall afoul of one or more of the GATS provisions on market access, domestic regulation and prudential regulation. The Secretariat was willing to admit that **Measure 3** conflicted with GATS rules. Meanwhile, the Secretariat probably felt no need to address **Measure 1,** since there hasn't been any major push towards that type of regulation.

Additional Commitments: How Binding?

The only place where U.S. firewalls are mentioned by name in the GATS is in the 1997 U.S. addition to its Schedule of Specific Commitments, in a paper referenced in the column titled "Additional Commitments." In this annexed paper, the Clinton administration committed to "reform" Glass-Steagall. What is the practical meaning of this commitment? GATS Article XVIII on "Additional Commitments" reads: "Members may negotiate commitments with respect to measures affecting trade in services not subject to scheduling under Articles XVI [Market Access] or XVII [National Treatment], including those regarding qualifications, standards or licensing matters. Such commitments shall be inscribed in a Member's Schedule."

As the Secretariat wrote in a 2002 paper, "Since Article XVIII does not contain any legal obligations in itself, commitments inscribed under it must take the form of undertakings, with full description of the obligations established therein. It should be noted that the conception of Article XVIII was linked to that of paragraph 4 of Article VI which establishes a work programme for the development of disciplines to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements and procedures do not constitute unnecessary barriers to trade in services … The legal obligations contained in those disciplines are of a very similar nature to the types of commitments that maybe negotiated under Article XVIII. It should be noted, however, that *the scope of Article XVIII goes beyond that of Article VI:4. The former provides the possibility for negotiating commitments on matters other than qualifications, standards or licensing*. The following sections of this note will provide illustrative examples in this regard. While Article XVIII provided a legal framework for Members to address restrictive measures not falling within the scope of Article XVI or XVII, it was considered that a more long term systemic solution would be desirable."

However, the WTO Dispute Settlement Body panel ruling in the *US – Gambling* goes farther than the non-legal Secretariat interpretation. Namely, the panel rule that Article XVIII is a provision that aims "at establishing legal obligations in relation to the use of (or rather the need to refrain from using) trade-restrictive measures."[51]

The 2002 Secretariat paper went on to address the specific U.S. entries, noting the commitment to Glass-Steagall reform, expanded inter-state branching, as well as SEC regulations that allow securities to be offered for sale. The paper states: "Leaving aside the question of the disciplining value of these commitments, it is interesting to note that some of the US additional commitments on banking and other financial services *seem to be related to market access and national treatment rather than Article XVIII type of issues*. Specifically, the issues of interstate acquisitions of banks on national treatment basis, or the removal of impediments to the offerings of securities in the US by foreign and domestic issuers, might be related to market access and national treatment, respectively."[52] [italics added]

To summarize, it appears that the Secretariat believes that WTO members have a limited ability to bring challenges against other countries' violations under GATS Article XVIII. (It would seem, however, that commercially significant deviations from the XVIII undertakings could be a basis for a nullification case.) At the same time, the Secretariat appears to question whether some or all of the XVIII inscriptions should not have instead been scheduled as limitations to Article XVI or XVII. Finally, the limited conclusions from the WTO Dispute Settlement Body appear to be at odds with the Secretariat, since the former refers to Article XVIII as a "legal obligation."

Additional GATS Market Access Rules for Developed Countries

There are other GATS provisions that could impact countries' ability to invoke size limitations or firewalls of the **Measures 1-5** types. Articles B(10-11) of the Understanding on Commitments in Financial Services – which most developed countries adopted – read:

> "Non-discriminatory Measures
> 10. Each Member shall endeavour to remove or to limit any significant adverse effects on financial service suppliers of any other Member of:
>
> > (a) non-discriminatory measures that prevent financial service suppliers from offering in the Member's territory, in the form determined by the Member, all the financial services permitted by the Member;
> > (b) non-discriminatory measures that limit the expansion of the activities of financial service suppliers into the entire territory of the Member;
> > (c) measures of a Member, when such a Member applies the same measures to the supply of both banking and securities services, and a financial service supplier of any other Member concentrates its activities in the provision of securities services; and
> > (d) other measures that, although respecting the provisions of the Agreement, affect adversely the ability of financial service suppliers of any other Member to operate, compete or enter the Member's market;
>
> provided that any action taken under this paragraph would not unfairly discriminate against financial service suppliers of the Member taking such action.

> 11. With respect to the non-discriminatory measures referred to in subparagraphs 10(a) and (b), a Member shall endeavour not to limit or restrict the present degree of market opportunities nor the benefits already enjoyed by financial service suppliers of all other Members as a class in the territory of the Member, provided that this commitment does not result in unfair discrimination against financial service suppliers of the Member applying such measures."

These provisions of the Understanding include "shall endeavor" language, and are notable for explicitly mentioning firewalls and branching restrictions as measures to be eliminated.

"Should Endeavor" Language – How Binding?

How binding is "shall endeavor" language? As the WTO Appellate Body has noted, "many binding legal texts employ the word 'should' and, depending on the context, the word may imply either an exhortation or express an obligation."[53] Indeed, the recent *Nations Energy v. Panama* case under the U.S.-Panama Bilateral Investment Treaty (BIT) looked at a "should strive" clause of that treaty. A dissenting tribunalist argued: "A mere change of words – from 'should accord' to 'should strive to accord' – does not change at all the meaning and character of the legal norm at stake… [the latter language] is not simply a pious exhortation directed at State virtue. It is a legal norm. The interpretive rules of the Vienna Convention on treaties, and particularly the articles that deal with the concept of effectiveness in treaty interpretation (Article 26) are also relevant here… the fact that a more or less incisive or expressive language is used does not change the unequivocal coercive nature of the norm…"[54] The tribunalist went on to rule that Panama was affirmatively bound by obligations worded in the "should strive" format.[55] This may inject a higher degree of uncertainty into the debate on the importance of seemingly exhortative provisions in trade and investment agreements.

The Understanding also contains a "standstill" requirement: "A. Standstill: Any conditions, limitations and qualifications to the commitments noted below shall be limited to existing non-conforming measures"). This is one of the most severe GATS requirements. The article suggests that, unless a Understanding-adopting country listed a size limitation in its 1997 schedule, it would not be able to impose one in a committed sector after that date.

The Understanding has the following B(5-6) provisions on commercial presence, mentioned in a quote in the previous section by the Secretariat:

> "5. Each Member shall grant financial service suppliers of any other Member the right to establish or expand within its territory, including through the acquisition of existing enterprises, a commercial presence.
>
> "6. A Member may impose terms, conditions and procedures for authorization of the establishment and expansion of a commercial presence *in so far as they do not*

> *circumvent the Member's obligation under paragraph 5 and they are consistent with the other obligations of the Agreement*."

In other words, countries can only maintain authorization procedures if they are consistent with market access, domestic regulation and other GATS requirements.

WTO members have already begun calling attention to the ways in which commitments under the Understanding could limit size limitations and firewalls. In meetings of the Committee on Trade in Financial Services in February 2011, one WTO member wrote:

> "14. The notion of 'too big to fail' has been a concern even prior to the crisis, but the financial crisis realized banking regulators' worst fears. The concern is that big banks might opt to exercise a lower level of care because they consider that they were too big to be allowed to fail. The new financial regulations put in place in at least one jurisdiction in 2010 include a decision to establish an entity with responsibility to check that companies are not becoming too big as to threaten financial stability and to devise means of reducing their size. The question now arises as to whether the rules applicable to large mega banks should be the same as those applicable to smaller banks. Should the rules vary according to the size and level of sophistication of the entity? Many small entities were allowed to fail even though, in some cases, their offences were less severe than those of large entities which were saved. Those who committed to the Understanding may find restrictions on size are contrary to the commitments given to limit adverse affects on financial service suppliers.
>
> 15. Other proposals for enhanced regulation include the suggestion for a mega-regulator which would oversee the individual regulators at the national level. The powers of enforcement of such a mega regulator and the power to impose sanctions would need to be carefully considered, so as not to endow an institution with excessive power. According to GATS Article XVI, governments cannot prohibit or limit the size or the total number of financial service suppliers in covered sectors. However, under a Financial Reform Bill 2010, an oversight entity is to be set up to do exactly that in one jurisdiction, that is, to make sure that the size of banks is reduced if they appear to be becoming too large."[56]

In sum, there seems to be a sound case that anti-TBTF measures would be restricted by GATS Article XVI, XVII or VI, and that such measures would be unlikely to be covered by the PMD. However, even if a respondent country were able to jump over the hurdles presented by these articles, the Understanding's standstill and market access rules may impose concurrent or additional restrictions on anti-TBTF measures for the countries that adopted it.

III. CONCLUSION AND POLICY FIXES

Whether an anti-TBTF measure is instituted through a firewall, a discretionary licensing procedure, or an outright size cap, this memo shows that it would likely fall afoul of WTO rules. Indeed, the text, negotiating history, FOIA documents and other materials outlined in this memo and its appendices confirm that interpretation.

It is hard to know whether USTR's denial of this potential conflict rests on a sincere (but misguided) reading of the market access rules, or of a mere dodging of a conflict they never intend to confront anyway. After all, the Clinton administration (where Timothy Geithner was the point person on financial services trade) committed to "reform" Glass-Steagall over a year before Congress had even repealed it. As a consequence, reinstitution of Glass-Steagall would likely run afoul of GATS rules. (For more detail on these arguments, see Appendix I.)

But as a practical matter, such a collision course may be unlikely, since, as recently as January 2011, Geithner's Treasury Department said, "We're not going to have just a set of immutable, quantitative criteria that say if you're above this amount of assets, you're too big to fail."[57] That posture certainly forecloses a possible trade pact challenge, even if the posture isn't good financial policy. Which came first: the "chicken" of GATS prohibition of anti-TBTF measures, or the "egg" of the attempt to never institute such measures in the first place? As the history shows, the two are interwoven and complement each other.

But even measures far short of Glass-Steagall could run into GATS problems. For instance, Europeans – with powerful financial interests back home behind them – have already expressed their disfavor with the so-called Volcker rule contained in the Dodd-Frank Act. As *Bloomberg News* reported:

> "European Union finance ministers are uniting to oppose President Barack Obama's proposal to limit banks' size and risk-taking, saying his plan may run counter to EU policy, according to a draft document. Their position, which they will ratify at a two-day meeting starting today, comes after Obama last month urged the adoption of the so-called 'Volcker rule,' named for former Federal Reserve Chairman Paul Volcker. The plan would bar commercial banks from owning hedge funds and limit how much they can trade for their own account. The finance officials gathering in Brussels will express 'their concern that the application of the Volcker rule in the EU may not be consistent with the current principles of the internal market and universal banking,' the document obtained by Bloomberg News said. 'Any policy choice should avoid pushing risks to other parts of the financial system.'"[58]

Both domestic- and foreign-owned multifunctional banks will fight any domestic firewall or other size limitation that forces them to break up lucrative business lines. If and when such institutions raise issues of GATS compatibility, this memo shows that they will (unfortunately) have some legal basis for doing so.

There are several steps that can be taken to foreclose any WTO challenge of bank-size limits. The simplest would be to eliminate GATS Article XVI(2) and the Understanding on

Commitments in Financial Services, and to eliminate the Working Party on Domestic Regulations and its draft disciplines. Also, for the United States in particular, the Obama administration should rescind the Doha Round services offer, and withdraw the Additional Commitments made by the Clinton administration that commits to lock-in of Glass-Steagall "reform." Similar eliminations should be made in our bilateral trade and investment agreements.

A series of intermediate steps may also be helpful (with corresponding changes in our bilateral trade and investment pacts):

1. BANS: Specify in the GATS text that commitments under Article XVI(2) do not require a country to remove bans on services, modes of service delivery, or means of service delivery (such as deposit services offered through a securities-dealing firm).
2. ECONOMIC NEEDS TESTS: It would be preferable to simply strike references to ENTs, since, as the Secretariat notes, they are poorly defined, and members appear to believe it can mean almost anything, including licensing procedures that do not involve strictly quantitative questions.
3. LEGAL ENTITY: Specify in the GATS text that "type of legal entity" in GATS Article XVI(2)(e) refers only to the typological distinctions between branches and subsidiaries, but does not refer to typological distinctions between financial service suppliers based on their specific permitted line of business.
4. ADDITIONAL COMMITMENTS: Specify in the GATS text that commitments under GATS Article XVIII impose no legal obligations – in order to foreclose the possibility raised in the *Nations Energy v. Panama* case that even aspirational clauses could be interpreted as binding.
5. PRUDENTIAL DEFENSE: Strengthen GATS Annex on Financial Services Article 2(a) dealing with prudential measures by removing the second sentence, and add "limiting the size of individual financial service suppliers" to the list of allowable policies.
6. FORK IN DOMESTIC REGULATIONS: State that measures that affect trade in financial services are disciplined only by this revised Annex 2(a) language, and not by any Article VI disciplines. This would ensure a heightened level of policy space to enact licensing requirements that result in firewalls.

APPENDIX I: U.S. SCHEDULE AND NEGOTIATING HISTORY SHEDS LIGHT ON ANTI-TBTF STRICTURES

How much did regulators worry about the possibility that firewalls might run afoul of the GATS? As this Appendix I shows, many negotiators certainly saw Glass-Steagall as a measure that impaired effective market access or competitive opportunities for banks. Moreover, U.S. negotiators scheduled several limitations in early versions of the U.S. offers and schedules that Glass-Steagall was likely to violate the GATS.

In June 2009, Public Citizen submitted a comprehensive Freedom of Information Act (FOIA) request to various U.S. government agencies for records related to the financial services negotiations. The documents we received – along with the available negotiating history from 1986 through 1997 from the gatt.stanford.edu database – indicate that it was commonly understood that the GATS could impact firewalls.

As early as December 1988, U.S. regulators from the Federal Reserve and Treasury were aware of the risk that European trade negotiators would push for removal of Glass-Steagall in the trade talks.[59] On September 4, 1989, the GATT Secretariat had issued a nearly 50-page analysis of "Trade in Financial Services." This was one of the first instances of an intergovernmental body acknowledging the legitimacy of the notion that it was meaningful to think about financial services in terms of trade policy. It outlined several types of national regulation that could limit financial services trade: notably, Glass-Steagall type firewalls were singled out repeatedly as posing obstacles to national treatment and market access.[60] The report also suggested that countries' freedom to choose the prudential regulations they prefer should be limited by trade considerations.[61]

In meetings from September 18-22, 1989, Canada said that non-discrimination was "not sufficient," and that rules would need to be developed to discipline "the regulatory separation of financial activities."[62] The reference to "regulatory separation of financial activities" put the United States on the defensive. The U.S. negotiators argued that: "it was important not to confuse policies developed in reaction to different prudential approaches with the need for effective market access and national treatment. Regulations separating commercial banking and securities activities, for example, did not of themselves constitute a restriction on market access nor a denial of national treatment."[63] The EC shot back that:

> "On the issue of market access, he noted that restrictions to the access of a specific financial services market should be subject to negotiation and to progressive elimination. He said that the institutional and/or geographical separation of various financial activities within the jurisdictions of importing countries could also constitute trade restrictions, noting that while there was no optimal regulatory structure it was still legitimate to seek to ensure that differing regulatory structures did not in themselves constitute barriers to effective market access. Regulatory measures which forced specialization in such a way as to render foreign companies simply unable to enter a market even as separate subsidiaries should in his view be on the negotiating table."[64]

In April 1990, a 29-year old Treasury Department official named Timothy Geithner raised the possibility that Glass-Steagall firewalls could be challenged under the new global rules. In a document released under FOIA, he wrote:

> "This memo examines a list of U.S. laws and regulations in the financial sector... that could be challenged by other countries in the context of the Uruguay Round negotiations... The list also includes complaints raised by Sir Leon Brittan in a recent visit to Washington and a list of problems identified in a 1989 publication by the Institute for International Bankers. There are several options for dealing with measures which may be inconsistent with the general principles under negotiation. First, we can draft around potential problem areas by defining specific provisions in a manner that preserves the present structure of the U.S. regulatory system. For example, we protect Glass-Steagall and other limitations on bank powers by drafting the market access and national treatment obligations with a reference to domestic financial institutions in like circumstances."[65]

Indeed, the market access text that Geithner was circulating at the time was much less intrusive than the final GATS text. It read:

> "Article 2: Market Access and National Treatment
>
> 2.1 Each party shall permit financial service providers of another Party:
> a) to establish or expand an enterprise for the provision of a financial service;
> b) to provide financial services through such an enterprise; and
> c) to conduct activities associated with the provision of a financial service on conditions that accord national treatment.
>
> 2.2 For the purposes of this agreement, national treatment means [treatment no less favorable than that accorded to its own financial service providers in like circumstances] [equality of competitive opportunity as compared to domestic financial service providers in like circumstances.] The point of comparison is the treatment accorded to financial services providers in like circumstances that are already established and operating in the territory of that Party…"

Thus, in the detailed breakout of the April 1990 memo, Geithner wrote:

> "[With regards to] Limitations on the powers of bank and non-bank financial institutions in the Bank Holding Company Act (BHCA) and Glass-Steagall. With the exception of the grand-fathered privileges noted below, these limitations apply equally to domestic and foreign financial institutions, and as a result they are consistent with the market access and national treatment provisions of our proposed agreement. Both the right to establish and the conditions on operation after establishment are defined with reference [to] national treatment, with domestic financial institutions in like circumstances as the point of comparison."[66]

Indeed, this version of the market access rules would have been unlikely to conflict with Glass-Steagall firewalls. Indeed, many early versions of the market access disciplines would have been unlikely to pose problems for Glass-Steagall.[67]

But a key European and Japanese negotiating objective for the Uruguay Round was removal of Glass-Steagall. For instance, the European Commission argued for repeal of Glass-Steagall, saying: "Where our partners have banking laws which are effectively non-discriminatory, but less liberal than our own, that will be a legitimate matter for negotiation. We will be fully entitled to argue that our most liberal banking market sets an example which our major trading partners should follow."[68] Europe also used reciprocity provisions in its Second Banking Directive in 1989 "as leverage in lobbying for reform of the Glass-Steagall Act" in and around the GATS negotiations.[69] Even Mexico submitted a memo to U.S. regulators during the Uruguay Round that complained about line-of-business separations in the U.S. market.[70]

European pressure to drop Glass-Steagall mirrored by pressure at home

U.S. negotiators bragged about their holding of the line against European demands that they get rid of Glass-Steagall. What they encountered was a deregulation-prone Congress that wanted U.S. banks to also be able to get into the securities business. In July 1990 congressional hearings, for instance, Rep. Doug Bereuter (R-Neb.) stated: "I can understand why European financial institutions are frustrated by Glass-Steagall and by our dual banking system, but they are no more frustrated than American institutions."[71] A year later, even the staff of the Chicago Mercantile Exchange complained that, "The Glass-Steagall Act and the Federal Reserve Board have held up U.S. and foreign banks and their affiliates from utilizing all the CME's product lines."[72]

Thus, the EC negotiating proposal for a GATT Financial Services Annex of July 10, 1990 proposal targeted Glass-Steagall type firewalls:

> "Parties shall not prevent financial services providers of other parties from offering in their territory all the financial services and products permitted by that party. A party may, in full respect of this rule, define the modalities of application of this principle subjecting access to certain activities by financial service providers established in its territory to specialisation or other requirements, such as the establishment of separate subsidiaries, branches or departments subject to different supervision, or a requirement to obtain separate authorizations…
>
> In cases where measures of a party, which apply in the same manner to domestic financial service providers as well as to financial service providers of other parties, have the effect of disadvantaging financial service providers of other parties in their ability to enter and compete in the market as compared to domestic ones, it will be considered that such measures are inconsistent with the obligation of national treatment when they:
> a) arbitrarily restrict the ability to compete of financial services providers of other parties in such a manner that they constitute a disguised discrimination against them; and

b) are not directly and principally justified in terms of public policy considerations."[73]

Since Glass-Steagall was at least partially justified as a way of safeguarding the profitability of deposit-taking banks,[74] Europeans might have deemed Glass-Steagall as "arbitrary."

The George H.W. Bush administration made its first conditional services offer in the Uruguay Round on November 13, 1990. No relevant limitations on market access were inscribed, but an annex on prudential measures in the offer outlined Glass-Steagall as a prudential measure: "The U.S. Department of the Treasury may refuse registration of bank representative offices if the registering entity is found not to be a depository institution" and "All financial service providers *other than federally regulated banking entities* wishing to provide broker-dealer investment banking services, either through a U.S. commercial presence or cross-border, must register as broker-dealers under Federal law and meet other requirements."[75] [italics added]

As shown in this inscription, U.S. negotiators considered securities registration requirements a potential conflict with GATS terms on domestic regulation, and appeared uncertain of how to deal with the prohibition on securities activities for national banks. When it doubt, carve out – which is what the Bush I administration did.

The version of text that developed country negotiators were working off of by June 21, 1991 (now liberated through FOIA) revealed ongoing disagreement about the implications of GATS market access rules for firewalls. The core market access article read:

> "1. Each Party shall permit financial services providers of other Parties to establish or expand within its territory, including through the acquisition of existing enterprises, a commercial presence.
>
> 2. Terms, conditions and procedures for authorization of the establishment and expansion of a commercial presence and their application to a financial service provider of another Party shall be consistent with national treatment."[76]

The national treatment obligation, for its part, read:

> "1. Each Party shall grant to financial service providers of any other Party, in the application of all measures, treatment no less favorable than that accorded to its financial services providers in like circumstances.
> 2. A measure of a Party, whether such measure accords different or identical treatment, shall be consistent with paragraph 1 only if it provides to financial service providers of any other Party equal competitive opportunities as are available to financial services providers of the Party in like circumstances. Equal competitive opportunities shall be deemed to exist where a measure does no disadvantage financial service providers of any other Party in their ability to compete as compared with the Party's financial service providers in like circumstances. In assessing equal competitive opportunities a principal factor will be the effect of a Party's measures. The absence of a significant market access share in the territory of a Party by financial service providers of any other Party shall not in itself constitute denial of equal competitive opportunities.

> 3. Equal Competitive Opportunities shall be deemed not to exist where a measure has the effect of disadvantaging financial service providers of other Parties in their ability to compete, in the form determined by the Party, in the market or in a particular segment of the market of the Party with financial service providers of that Party in the market or segment of the market in like circumstances."

The Treasury Department officials circulating this text noted that this final paragraph was a U.S. proposal. If accepted, then the text that would become Article B(10) of the Understanding on Commitments in Financial Services (dealing with institutional separation of banking and securities activities) would be deleted.

By December 20, 1991, the so-called "Dunkel Draft" of the GATS was completed, and the current texts of GATS Article XVI(2), the Annex and the Understanding were included therein.[77] What was the U.S. to do about its Glass-Steagall problem at that point, given that several of the subparagraphs in Article XVI(2) could conflict with firewalls?

Again, when in doubt, carve out. The U.S. revised conditional offer from January 21, 1992 deleted the headnote contained in the November 13, 1990 offer, and noted that "The United States undertakes its commitments on insurance with respect to the 'Understanding on Commitments in Financial Services.'"[78] An explanatory note introducing the March 26 revised conditional U.S. offer elaborated on the import of this inscription:

> "This offer is based on the Articles of Agreement to the General Agreement on Trade in Services (the Framework), the Annex on Financial Services (the Annex), and the Understanding on Commitments in Financial Services (the Understanding) contained in the 20 December 1991 document MTN.TNC/W/FA. *Pursuant to these documents, the market access obligations of the Understanding have been adopted as an alternative to the market access obligations of the Framework. The cross-border, movement of consumer, commercial presence, and movement of personnel obligations of the Understanding thus substitute for the corresponding obligations of the Framework*."

An endnote appended to the new proposed schedule was even more explicit:

> "1. *Because* the Understanding is adopted as an alternative approach to Part III of the Framework, the terms, limitations and conditions of market access listed in this offer relate to provisions of the Understanding; the provisions of Article XVI of the Framework are not addressed.
>
> *It is understood that the institutional framework of a Party's financial sector relating to the separation of financial activities does not constitute a market access restriction per se*" [underline in original; italics added].[79]

The logic of these two sentences appearing together in the March 26 offer suggests that USTR was worried that GATS Article XVI *on its own* might limit firewalls, which is why the emphasis was repeatedly put on the United States intending to be bound to the market access provisions of the Understanding, but not of the core GATS. Indeed, while the Understanding is much more restrictive of national policy space in certain ways (note the "Standstill" provision), its market access provisions in Articles B(5-6) are much less prescriptive than Article XVI(2). So, if the U.S. financial services commitments were taken in accord with the Understanding but not GATS Article XVI(2), then Glass-Steagall may have been protected.

(It seems that, up until the very last minute before the Dunkel Draft, the draft market access provisions of the Understanding was explicitly seen as an alternative to GATS Article XVI. Indeed, the November 12, 1991 draft states that "'Market access' means, with respect to financial services, the obligations referred to in Article XVI of the [GATS], except that, where a party has made commitments pursuant to paragraph 1 of Article 4 of the Annex [i.e. Understanding], 'market access' means the obligations set out in paragraphs 1 to 10 under the title 'Market Access' in the attachment to the Annex." This alternative structure may have better insulated Glass-Steagall over the long run than the interpretation – prevailing today – that the Understanding represents additional commitments to the GATS, not substitute commitments.)

This concern for a GATS Article XVI threat to firewalls continued for years into the Clinton administration:

- A headnote to the October 1, 1993 revised conditional U.S. offer reads: "The institutional framework of the United States relating to the separation of financial activities is not considered to constitute a market access restriction per se" [underline in original].[80]
- A headnote to the December 7, 1993 draft final U.S. schedule reads: "The United States undertakes its commitments on financial services with respect to the 'Understanding on Commitments in Financial Services.' Thus, the market access obligations of the Understanding have been addressed in this offer as an alternative to the market access obligations of the Framework. Service suppliers choosing to supply a service through a juridical person constituted under the laws of the United States are subject to non discriminatory limitations on juridical form. The institutional framework of the United States relating to the separation of financial activities is not considered to constitute a market access restriction per se."[81]
- A headnote to the April 15, 1994 Schedule of Specific Commitments read: "Commitments in these subsectors are undertaken in accordance with the Understanding on Commitments in Financial Services (the Understanding), which is incorporated by reference into this schedule, and under Article XVII of the General Agreement on Trade in Services (GATS). These subsectors are unbound with respect to Article XVI of the GATS. In addition, 1) this subsector shall be unbound with respect to market access through modes 1 and 3 for the expansion of existing operations, the establishment of a new commercial presence (in mode 3 only) or the conduct of new activities, and 2) service suppliers choosing to supply a service through a juridical person constituted under the laws of the United States are subject to non discriminatory limitations on juridical form."[82]

This headnote indicated that foreign firms operating in the U.S. (i.e. through Mode 1) could not expect to be granted the market access opportunities (i.e. new commercial presence and expansion into new unfirewalled activities) envisioned in Article XVI(2) of the GATS. Rather, they would be allowed the right to establish or expand consistent with the "terms, conditions and procedures for authorization and expansion of a commercial presence" (as per Articles B(5-6) of the Understanding) that U.S. firms enjoyed.

While the Uruguay Round formally concluded in 1994, members agreed to continue negotiating financial services, which lasted through 1997. The relevant headnotes to the July 28, 1995 supplement to the Schedule of Specific Commitments read:

> "1. Commitments in these subsectors are undertaken in accordance with the Understanding on Commitments in Financial Services (the Understanding). Specifically, market access commitments under modes (a)-(d) as set forth in paragraph 2 of Article I of the Agreement are undertaken only with respect to the Understanding and paragraph 1 of Article XVI of the Agreement.
>
> 2. This subsector shall be unbound with respect to market access through modes 1 and 3 for the expansion of existing operations, the establishment of a new commercial presence (in mode 3 only) or the conduct of new activities. …
>
> 4. Service suppliers choosing to supply a service through a juridical person constituted under the laws of the United States are subject to non discriminatory limitations on juridical form."[83]

Headnote 1 and 2 are essentially the same carve-out that the U.S. made in 1994 (although FOIA documents reveal that the extension of U.S. Article XVI commitments to the first paragraph of that article was the means by which the U.S. committed to the free transfers provisions contained in that paragraph).[84] Headnote 4 is more interesting. Under the narrow reading of the term "juridical form" (i.e. a requirement to incorporate or set up only branch operations), it is not particularly relevant to Glass-Steagall. As we outline in Appendix II, the U.S. firewalls were not administered through a requirement to be a "corporation" or a "branch" (or not to be), but were rather a subsequent regulatory requirement to authorize (or not) certain activities for corporations. It is only under a very broad reading of the typology of "juridical form" (such as that hypothesized by scholar Markus Krajewski) that distinctions between "commercial banks" and "deposit banks" are covered by GATS Article XVI(2)(e) in the first instance, or by a carveout like Headnote 4 in the second instance. In other words, Headnote 4 does not offer much clarity of the level of protection offered to policies like Glass-Steagall.

The July 17, 1997 conditional U.S. offer contained the above language, but deleted paragraph 2, which our FOIA documents reveal to have been controversial between WTO members and within the agencies.[85] The December 9, 1997 revised conditional U.S. offer changed paragraph 1 of the above quote to read:

> "1.Commitments in these subsectors are undertaken in accordance with the Understanding on Commitments in Financial Services (the "Understanding"), subject to the limitations and conditions set forth in these headnotes and the schedule below."[86]

It also added a new market access limitation across all banking and securities subsectors:

> "Unbound with respect to paragraph 2(e) of Article XVI of the Agreement, and paragraphs A, B.5 and B.6 of the Understanding in relation to the expansion, via the establishment of a branch or the acquisition of one or more branches of a bank without acquisition of the entire bank, by a foreign bank into another state from its 'home state,' as that term is defined under applicable law."

Paragraph 2(e) of Article XVI pertains, as we noted above, to incorporation and branching distinctions, and is unlikely to cover authorization for commercial banking under Glass-Steagall and other former U.S. statutes.

By mid July, the U.S. delegation to the WTO's Committee on Trade in Financial Services was talking up its plans for accelerating the death of Glass-Steagall, even before Congress had approved this proposal back at home:

> "The representative of the United States said that his country recognized its responsibility to continue to provide a more efficient financial sector, both for U.S. consumers and international participants in the U.S. financial sector … Currently, they were looking at the next major step in terms of liberalizing their market. *The Treasury Department was moving ahead in terms of proposing the removal of the 1933 Glass Steagall Act which segregated securities, insurance, and banking functions within the U.S. market*. In light of the current regulatory system and the prudential environment, they were examining whether some reform of the segregation of the financial markets was long overdue in order to go back to a more efficient and interactive market. The Treasury Department was suggesting that banks be able to acquire securities and insurance companies and vice versa. Congress was beginning to have hearings on the proposal and the debate was opened to comments from foreign participants in the U.S. market. In addition, the Treasury had suggested to examine whether the financial sector should be allowed to enter into the commercial sector; in other words, whether a commercial bank in the U.S. should be permitted to acquire a retail outlet or manufacturing entity, although no specific recommendations had yet been made in the area. He hoped progress would be made regarding the Glass Steagall reform and said that any reform achieved would be immediately available to foreign participants in the U.S. market."[87] [italics added]

The December 12, 1997 revised conditional U.S. offer formalized this promised by adding an entry into its column on "Additional Commitments" that stated: "The United States undertakes the obligations contained in Additional Commitments Paper II attached hereto." The attached paper stated: "The Administration has expressed its support for Glass-Steagall reform on a national treatment basis and will work with Congress to achieve an appropriate framework to accomplish this objective."[88]

The inclusion of Glass-Steagall in the Additional Commitments column is interesting, as the WTO Secretariat noted in its 2002 paper that we cited above: "it is interesting to note that some of the US additional commitments on banking and other financial services *seem to be related to market access and national treatment rather than Article XVIII type of issues*."[89] Moreover, as the WTO had noted even earlier in1998, "*there may be differences of views as to whether certain measures can be considered as prudential, and therefore, not subject to scheduling under the*

GATS… Traditional line-of-business restrictions, such as the segregation of banking, securities and insurance businesses such as those existing in the U.S. and Japan, have prudential objectives, but they *can be perceived as having non-prudential elements* from the point of view of European countries with a tradition of universal banking."[90] In other words, why was the U.S. going to more circuitous route of Article XVIII, rather than taking the safer road of scheduling a market access limitation for its firewalls in its GATS schedule, as did so many other countries?

On December 13, 1997, Treasury Secretary Robert Rubin issued a statement with USTR Charlene Barshefsky that said, "We are pleased to announce that the United Stated has led a successful effort to conclude multilateral negotiations that will open financial services markets to US suppliers of banking, securities, insurance and financial data services…. Let us conclude by thanking Ambassador Jeffrey Lang, the Deputy United States Trade Representative, and Tim Geithner, Assistant Secretary for International Affairs of the Treasury Department, who have worked tirelessly, not just in the home-stretch of the past few weeks, but over the past two years visiting Asian capitals, being omni-present in Geneva, working with our trading partners, and doing everything to make sure there was an end-game. Similarly, Meg Lundsager, Mathew Hennesey and Michael Kaplan at Treasury and Wendy Cutler and Laura Lane at USTR and the rest of our team have our deepest appreciation for their hard work."[91] On December 18, Deputy Treasury Secretary Larry Summers held a press conference with Barshefsky, praising the financial services deal, Geithner's role in it, and noting that South Korea would be locking in some of its domestic deregulation through the GATS.[92]

Robert Rubin and Laura Lane went along to work for Citigroup, the primary beneficiary of the Glass-Steagall repeal locked in through GATS commitments. Citigroup's expansion and combination of activities would go on to threaten the bank's survival and the economic system as a whole. Geithner went along to become a primary advocate for financial services rules in FTAs, and for the bailout of TBTF banks at the Federal Reserve and later in the Obama administration.

In WTO meetings in April 2000, the Clinton administration gloated about its recent deregulatory victory, and noted that it would go a long ways towards addressing foreign banks' concerns about operating in the U.S. market.[93] Indeed, in meetings as recently as December 2002, the U.S. delegation to the WTO would brag that Glass-Steagall repeal was a model of regulatory transparency and consulting with private stakeholders that should be emulated by other members.[94]

More recently, the U.S. initial offer in the Doha Round in March 2003 includes a new headnote that reads: "Regarding the existing U.S. Additional Commitments Paper II, (1), the United States notes passage of the Gramm-Leach-Bliley Act of 1999 which establishes a framework for financial modernization under which conglomerates can provide a variety of financial services in the United States."[95] The Obama administration has announced no changes to this offer since it took office. In other words, a conclusion of the Doha Round may further lock-in the repeal of Glass-Steagall.

++

In summary, there were a few moments during the Uruguay Round and subsequent financial services talks when Glass-Steagall may have been protected. First, in the market access obligations in many of the GATS draft text before 1991, the focus of market access rules was on equality of competitive opportunity. As Geithner noted early on, the competitive opportunities U.S. banks have in the U.S. market would be open to foreign firms. Opportunities that were not – like commercial banks offering securities trading on a massive scale – would not be open to foreign firms under the GATS. Under that form of GATS commitment, Glass-Steagall would have likely been protected.

Second, when negotiators bifurcated the market access obligations of GATS Article XVI(2) and the Understanding (and U.S. negotiators were explicit that they undertook obligations under the latter but not the former), then Glass-Steagall was arguably protected. "Arguably," because even USTR suggested that the Understanding itself contained broadly similar market access obligations as Article XVI(2) – with the only exception that USTR noted in the FOIA documents pertaining to interstate branching.

But by December 1997, the GATS market access rules were less forgiving, the Understanding commitments coexisted with the core GATS commitments, and the U.S. not only did not have a carve-out that protected Glass-Steagall. Indeed, the Clinton administration had gone the extra step of committing to "reform" Glass-Steagall before Congress had even passed its repeal. Any reinstitution of Glass-Steagall – without reforming the underlying GATS market access rules or cleaning up the U.S. schedule – would likely violate the U.S.' market access commitments. (At a minimum, any reinstitution could be ground for a case that the U.S. "nullified or impaired" the concessions that the U.S. signaled it would give through its 1997 Additional Commitments.)

For this reason, it is important that advocates for a safer and more manageable banking system that serves the real economy advocate also for GATS reform.

Appendix II: U.S. Legislation, Past and Present

In making a determination of the GATS compatibility of Glass-Steagall, it is useful to know *how the Act worked.* For those wishing to skip over this Appendix II, suffice it to say that the particular firewall used in the U.S. historically was a condition for licensing and authorization for corporations formed for the purpose of offering commercial banking or existing as a bank holding company. While this would seem to put the Act under the purview of GATS Articles VI, XVIII and/or Annex 2(a) rather than Article XVI, we explored earlier how licensing procedures could be considered violations of market access commitments. Thus, exactly under which GATS provision Glass-Steagall type firewalls would fall is unclear, and countries arguing for an Article XVI violation could find significant support for that argument. Moreover, strong firewalls invite circumvention, and regulators might need to adjust their administration of a law so that the line between discretionary and non-discretionary licensing could be crossed in a way that would have implications for GATS Article XVI coverage.

Origins

The National Bank Act of 1864 established what later became known as the national bank charter. The Act specified the following procedure:

1. associations of at least five people could “execute” (i.e. write up) an articles of association to determine the names and directors of a “national association” (Sections 3, 44);
2. once a majority of the directors agree to the articles of agreement, they can “execute” an organizational certificate describing their place of operations, compliance with minimum capital requirements and other facts (Sections 6-7, 44);
3. at this point in the process, the association becomes “a body corporate, but shall transact no business except as may be incidental to its organization and necessarily preliminary, until authorized by the comptroller of the currency to commence the business of banking” (Sec 8);
4. the association submits the notarized certificate to the comptroller, testifying “that at least fifty per centum of its capital stock has been paid in as aforesaid, and that such association has complied with all the provisions of this act as required to be complied with before such association shall be authorized to commence the business of banking;” (Section 17);
5. at that point, “the comptroller shall examine into the condition of such association, ascertain especially the amount of money paid in on account of its capital, the name and place of residence of each of the directors of such association, and the amount of the capital stock of which each is the bona fide owner, and generally whether such association has complied with all the requirements of this act to entitle it to engage in the business of banking; and shall cause to be made and attested by the oaths of a majority of the directors and by the president or cashier of such association, a statement of all the facts necessary to enable the comptroller to determine whether such association is lawfully entitled to commence the business of banking under this act” (Section 17);
6. if the comptroller is satisfied with the examination, “he shall give to such association a certificate, under his hand and seal, that such association has complied with all of the provisions of this act,” and the association then prints that certificate in a local newspaper (Sections 18, 44);
7. the comptroller becomes responsible for conducting regular bank examinations (Section 54);

8. “if the directors of any association shall knowingly violate, or knowingly permit any of the officers, agents, or servants of the association to violate any of the provisions of this act, all the rights, privileges, and franchises of the association derived from this act shall be thereby forfeited.” (Section 53)[96]

In sum, a group of people first become an association, then a corporation, but can only conduct a certain line of business once is has received proper authorization. This basic schema still holds in U.S. law.

While there was no legislatively-mandated firewall in the 19th Century, the Supreme Court issued decisions in the 1890s prohibiting national banks from engaging directly in securities activities. However, bank affiliates were not subject to this prohibition.[97]

The Federal Reserve Act of 1913 modified this procedure:

1. It stated that “The terms ‘national bank’ and ‘national banking association’ used in this Act shall be held to be synonymous and interchangeable. The term ‘member bank’ shall be held to mean any national bank, State bank, or bank or trust company which has become a member of one of the reserve banks created by this Act.” (Section 1) Banks became member banks by subscribing to the stock of their district Federal Reserve bank, and they would then receive voting rights to elect the leadership therein. (Section 2)
2. The Act held that, “should any national banking association in the United States now organized fail within one year after the passage of this Act to become a member bank or fail to comply with any of the provisions of this Act applicable thereto, all of the rights, privileges, and franchises of such association granted to it under the national-bank Act, or under the provisions of this Act.” After a judicial process, the banking association could ultimately be dissolved. (Section 2)
3. It established a process for state-chartered to apply to the Federal Reserve to become members by subscribing to the Fed stock, with a process for the Fed to kick them out and return the stock if they violated the terms of the Act. (Section 9)[98]

In the wake of the Great Depression, pressure grew for a legislative response to inside-dealing. As Essential Information summarized in a March 2009 report,

> “The 1932-34 Pecora Hearings, held by the Senate Banking and Currency Committee and named after its chief counsel Ferdinand Pecora, investigated the causes of the 1929 crash. The committee uncovered blatant conflicts of interest and self-dealing by commercial banks and their investment affiliates. For example, commercial banks had misrepresented to their depositors the quality of securities that their investment banks were underwriting and promoting, leading the depositors to be overly confident in commercial banks’ stability. First National City Bank (now Citigroup) and its securities affiliate, the National City Company, had 2,000 brokers selling securities. Those brokers had repackaged the bank’s Latin American loans and sold them to investors as new securities (today, this is known as “securitization”) without disclosing to customers the bank’s confidential findings that the loans posed an adverse risk. Peruvian government bonds were sold even though the bank’s staff had internally warned that “no further national loan can be safely

> made" to Peru. The Senate committee found conflicts when commercial banks were able to garner confidential insider information about their corporate customers' deposits and use it to benefit the bank's investment affiliates. In addition, commercial banks would routinely purchase the stock of firms that were customers of the bank, as opposed to firms that were most financially stable. The Pecora hearings concluded that common ownership of commercial banks and investment banks created several distinct problems, among them: 1) jeopardizing depositors by investing their funds in the stock market; 2) loss of the public's confidence in the banks, which led to panic withdrawals; 3) the making of unsound loans; and 4) an inability to provide honest investment advice to depositors because banks were conflicted by their underwriting relationship with companies."[99]

Creation of Legislative Firewalls

The Glass-Steagall Act of 1933 amended the Federal Reserve Act to state that:

- For national banks, "The business of dealing in investment securities by the association shall be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities."[100] (Section 16; this did contain a set of loopholes.)
- "After one year from the date of the enactment of this Act, no member bank shall be affiliated … with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities."[101] (Section 20)
- Stated, "it shall be unlawful For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor." (Section 21)

But Glass-Steagall was not an airtight solution. As the Essential Information report stated:

> "A legal construct known as a 'bank holding company' was not subject to the Glass-Steagall restrictions. Under the Federal Reserve System, bank holding companies are 'paper' or 'shell' companies whose sole purpose is to own two or more banks. Despite the prohibitions in Glass-Steagall, a single company could own both commercial and investment banking interests if those interests were held as separate subsidiaries by a bank holding company. Bank holding companies became a popular way for financial institutions and other corporations to subvert the Glass-Steagall wall separating commercial and investment banking. In response, Congress enacted the Bank Holding Company Act of 1956 (BHCA) to prohibit bank holding companies from acquiring 'non-banks' or engaging in 'activities that are not closely related to banking.' Depository institutions were considered 'banks' while investment banks (e.g. those that trade stock

> on Wall Street) were deemed 'nonbanks' under the law. As with Glass-Steagall, Congress expressed its intent to separate customer deposits in banks from risky investments in securities. Importantly, the BHCA also mandated the separation of banking from insurance and non-financial commercial activities. The BHCA also required bank holding companies to divest all their holdings in non-banking assets and forbade acquisition of banks across state lines."[102]

The Act put the onus on the Federal Reserve Board of Governors to receive and approve applications for holding companies to be deemed "bank holding companies," and allowed the banks' primary regulators (the Comptroller or a state supervisor) to disapprove of the application, thus triggering a set of hearings administered by the Board. (Section 3) The Board was empowered to conduct examinations of bank holding companies to ensure compliance with the bill, but encouraged to use the examinations of the banks' primary regulators. (Section 5) Violations of the act were subject to fines and/or jail time. (Section 8)[103]

Cracks in the Edifice

Because the United States maintained what is known as a "dual banking" or "dual chartering system," state-chartered, "non-member" banks were not always required to follow the federal policy of firewalls. Moreover, many foreign-owned banking corporations established a commercial presence in the U.S. market only by means of agencies or branches. This meant, in the words of the Federal Reserve's Sydney J. Key, that "foreign banks enjoyed a number of advantages over their U.S. counterparts" including being "able to operate both securities affiliates and deposit-taking branches in the United States."[104] The International Bank Act of 1978 changed this by applying "the nonbanking provisions of the BHCA to the direct and indirect U.S. operations of foreign banks with U.S. agencies and branches."[105] The Fed accomplished this objective by treating foreign banks as bank holding companies for the purposes of the BHCA rules.[106]

Beginning in the 1980s (and following a key 1971 Supreme Court decision), the Federal Reserve began to approve securities-related activities for subsidiaries of bank holding companies, so long as they were not "engaged principally" in such matters.[107] Congress also gave the Federal Reserve the right to approve securities-related activities for the foreign operations of U.S.-chartered banks that would have been prohibited in their domestic operations.[108]

Throughout the 1990s, various bills were introduced and voted down in Congress that would have repealed Glass-Steagall fully.

As the Financial Crisis Inquiry Commission (FCIC) noted,

> "In 1998, Citicorp forced the issue by seeking a merger with the insurance giant Travelers to form Citigroup. The Fed approved it, citing a technical exemption to the Bank Holding Company Act, but Citigroup would have to divest itself of many Travelers assets within five years unless the laws were changed. Congress had to make a decision: Was it prepared to break up the nation's largest financial firm? Was it time to repeal the Glass-Steagall Act, once and for all?... In November 1999, Congress passed and

President Clinton signed the Gramm-Leach-Bliley Act (GLBA), which lifted most of the remaining Glass-Steagall-era restrictions. The new law embodied many of the measures Treasury had previously advocated. The New York Times reported that Citigroup CEO Sandy Weill hung in his office 'a hunk of wood—at least 4 feet wide—etched with his portrait and the words 'The Shatterer of Glass-Steagall.''"[109]

Section 101 of the Gramm-Leach-Bliley Act of 1999 simply repealed Sec. 20 of the Glass-Steagall Act, and made other alterations to the provisions of that act and the BHCA that amounted to a removal of most restrictions on financial conglomerates' ability to hold commercial and investment banking, and insurance, operations. The FCIC then wrote,

"Citigroup's investment bank subsidiary was a natural area for growth after the Fed and then Congress had done away with restrictions on activities that could be pursued by investment banks affiliated with commercial banks. One opportunity among many was the CDO business, which was just then taking off amid the booming mortgage market….

"The CDO team at Citigroup had jumped into the market in July 2003 with a $1.5 billion CDO named Grenadier Funding that included a $1.3 billion tranche backed by a liquidity put from Citibank. Over the next three years, Citi would write liquidity puts on $25 billion of commercial paper issued by CDOs, more than any other company…

"The CDO desk stopped writing liquidity puts in early 2006, when it reached its internal limits. Citibank's treasury function had set a $23 billion cap on liquidity puts; it granted one final exception, bringing the total to $25 billion. Risk management had also set a $25 billion risk limit on top-rated asset-backed securities, which included the liquidity puts. Later, in an October 2006 memo, Citigroup's Financial Control Group criticized the firm's pricing of the puts, which failed to consider the risk that investors would not buy the commercial paper protected by the liquidity puts when it came due, thereby creating a $25 billion cash demand on Citibank. An undated and unattributed internal document (believed to have been drafted in 2006) also questioned one of the practices of Citigroup's investment bank, which paid traders on its CDO desk for generating the deals without regard to later losses: 'There is a potential conflict of interest in pricing the liquidity put cheep [sic] so that more CDO equities can be sold and more structuring fee to be generated.' The result would be losses so severe that they would help bring the huge financial conglomerate to the brink of failure…"[110]

As Citigroup teetered and almost fell in November 2008, FDIC officials urged action, "the main point [of which] is to let the world know that we will not pull a Lehman… at this stage, it is probably appropriate to be clear and direct that the U.S. government will not allow Citi to fail to meet its obligations."[111]

The rest, as they say, is history.

ENDNOTES

[1] Todd Tucker is research director with Public Citizen's Global Trade Watch. He thanks Mary Bottari, Jane D'Arista, Gerry Epstein, Ellen Gould, Jane Kelsey, Markus Krajewski, Jan Kregel, Petros Mavroidis, Chakravarthi Raghavan, Sanya Reid Smith, Riaz Tayob, David Arkush, Sarah Edelman, Nicholas Florko, Greg Greenberg, Travis McArthur, Craig Mehall, Sonal Mittal, Hugh Schlesinger, Lori Wallach and Rob Weissman for helpful comments. Due to a technical error, the version of this paper originally uploaded on May 10 was an earlier version. This version is the final memorandum.

[2] Article 13.4 of the Korea FTA reads: "ARTICLE 13.4: MARKET ACCESS FOR FINANCIAL INSTITUTIONS: A Party shall not adopt or maintain, with respect to financial institutions of the other Party or investors of the other Party seeking to establish such institutions, either on the basis of a regional subdivision or on the basis of its entire territory, measures that: (a) impose limitations on: (i) the number of financial institutions whether in the form of numerical quotas, monopolies, exclusive service suppliers, or the requirements of an economic needs test; (ii) the total value of financial service transactions or assets in the form of numerical quotas or the requirement of an economic needs test; (iii) the total number of financial service operations or on the total quantity of financial services output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test; or (iv) the total number of natural persons that may be employed in a particular financial service sector or that a financial institution may employ and who are necessary for, and directly related to, the supply of a specific financial service in the form of numerical quotas or the requirement of an economic needs test; or (b) restrict or require specific types of legal entity or joint venture through which a financial institution may supply a service."

[3] Economic Policy Institute, September 9, 2009. Available at: http://www.epi.org/publications/entry/event20090909/

[4] Simon Johnson, testimony before Joint Economic Committee, April 21, 2009. Available at: http://jec.senate.gov/public/?a=Files.Serve&File_id=20a37890-6f4f-4d11-92e3-449be6b7cbba

[5] John H. Boyd and Ravi Jagannathan, "Avoiding The Next Crisis," *The Economists' Voice*, July 2009.

[6] Jan Kregel, "Observations on the Problem of 'Too Big To Fail / Resolve,'" Levy Economics Institute of Bard College Policy Note 2009/11, 2009. Available at: http://ideas.repec.org/p/lev/levypn/09-11.html

[7] Jan Kregel, "No Going Back: Why We Cannot Restore Glass-Steagall's Segregation of Banking and Finance," Levy Economics Institute of Bard College Public Policy Brief No. 107, 2010. Available at: http://ideas.repec.org/p/lev/levppb/ppb_107.html

[8] Landon Thomas and Eric Dash, "British Bank Proposal Expected to Include Stiff Rules," *New York Times,* April 7, 2011. Available at: http://www.nytimes.com/2011/04/08/business/global/08pound.html?_r=1&pagewanted=print

[9] In fact, as a recent WTO paper makes clear, many neoliberal commentators have associated higher finance/GDP ratios with better development outcomes. See discussion of Levine's research in WTO, "Trade in Financial Services and Development," Background Note by the Secretariat, S/FIN/W/76, May 3, 2011. This correlation seems to invert the actual causation in the development process.

[10] According to the GATS Annex on Financial Services, "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; (iv) Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services." And "Banking and other financial services (excluding insurance): (v) Acceptance of deposits and other repayable funds from the public; (vi) Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transaction; (vii) Financial leasing; (viii)All payment and money transmission services, including credit, charge and debit cards, travellers cheques and bankers drafts; (ix) Guarantees and commitments; (x)Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following: (A) money market instruments (including cheques, bills, certificates of deposits); (B)foreign exchange; (C)derivative products including, but not limited to, futures and options; (D) exchange rate and interest rate instruments, including products such as swaps, forward rate agreements; (E)transferable securities; (F)other negotiable instruments and financial assets, including bullion. (xi) Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues; (xii) Money broking; (xiii) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services; (xiv) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments; (xv) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services; (xvi) Advisory, intermediation and other auxiliary financial services on all the activities listed in subparagraphs (v)

through (xv), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy."

[11] According to the GATS Article 1, "For the purposes of this Agreement, trade in services is defined as the supply of a service: (a) from the territory of one Member into the territory of any other Member; (b)in the territory of one Member to the service consumer of any other Member; (c)by a service supplier of one Member, through commercial presence in the territory of any other Member; (d)by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member." These are referred to respectively as Modes 1 (cross-border supply), 2 (consumption abroad), 3 (commercial presence), and 4 (movement of natural persons).

[12] "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services (AB-2005-1)," Appellant Submission Of The United States Of America, January 14, 2005, at footnote 167.

[13] As it happens, a ratio is what the WTO's GATS Scheduling Guidelines envision as a possible violation of GATS Article XVI(2)(b), where they cite "Foreign bank subsidiaries limited to x percent of total domestic assets of all banks" as an example of a measure that would need to be listed in a country's schedule if it wanted to maintain such a size cap. See WTO, "Guidelines For The Scheduling Of Specific Commitments Under The General Agreement On Trade In Services (GATS)," March 23, 2001, at para 12.

[14] "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services - AB-2005-1 - Report of the Appellate Body," WTO Document WT/DS285/AB/R, July 4, 2005, at paras 52, 222, 236, and 264.

[15] Markus Krajewski, *National Regulation and Trade Liberalization in Services*, (The Hague: Klewer Law International, 2003), at 91. Full quote: "Article XVI:2(d) answers the similar question concerning limitation of employees clearly, because it prohibits limitations on the total number 'that may be employed in a particular sector' and limitations of the total number 'that a service supplier may employ.' Therefore, subparagraph (d) addresses both the abstract limitation concerning the entire sector and the concrete limitation concerning the individual service supplier. It can thus be argued that these subparagraphs address only limitations of the total number of service operations… If such an understanding were adopted, an individual limitation of the value of transactions or the number of service operations could not be considered a restriction on market access."

[16] "This type of restriction does not abound in schedules, and the provision itself (Art. XVI.2b GATS) is not absolutely clear… this type of restriction may apply at the market level (e.g. foreign bank subsidiaries limited to x% of total domestic assets of all banks), *or at the individual institution level* (e.g. foreign banks are subject to per client foreign currency credit extension limit of 25% of the net worth of their head office)" [italics added]. Petros Mavroidis, "Highway XVI re-visited: the road from non-discrimination to market access in GATS," *World Trade Review,* 6:1, 2007, at 17-18.

[17] Quoted in regard to Article 13.4 of the Korea FTA. See Mike Alberti, "Could US-Korea trade agreement deter enhanced regulation of financial services?" *Remapping Debate,* Feb. 1, 2011. Available at: http://remappingdebate.org/article/could-us-korea-trade-agreement-deter-enhanced-regulation-financial-services?page=0,1

[18] WTO Dispute Settlement Body, "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services," WTO Document WT/DS285/R, Nov. 10, 2004, at paras 6.342, 6.345 and 6.356. The Panel wrote: "in subparagraph (c), as indeed in subparagraph (d), the word 'number' is qualified by the adjective 'total.' This *may be* explained by the fact that subparagraph (c) relates to limitations on the aggregate of the service operations or output whereas subparagraph (a) contemplates that limits may be imposed on the number of suppliers by reference to a criterion other than the national or regional aggregate. However, when a Member's laws prohibit the supply of a certain service by a certain mode, *the word 'total' is without significance*, since the number will always be zero… Unlike subparagraph (a), subparagraph (c) of Article XVI:2 contains a reference to 'total' number of service operations and 'total' quantity of service output. The 1993 Scheduling Guidelines state that: 'It should be noted that the quantitative restrictions specified in subparagraphs (a) to (d) refer to maximum limitations.' This suggests that the word 'total' in Article XVI:2(c) serves the purpose of indicating that limitations covered by Article XVI:2(c) must impose maximum limits on services operation and/or service output. Accordingly, *such differences as there are between the wording of subparagraphs (a) and (c) of Article XVI:2 do not warrant a different conclusion as to the impact of the two subparagraphs* in the present case." [italics added]

[19] See Mike Alberti, "Could US-Korea trade agreement deter enhanced regulation of financial services?" *Remapping Debate,* Feb. 1, 2011. Available at: http://remappingdebate.org/article/could-us-korea-trade-agreement-deter-enhanced-regulation-financial-services?page=0,1

[20] WTO Dispute Settlement Body, "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services," WTO Document WT/DS285/R, Nov. 10, 2004, at para 3.41. "The context for the U.S. Schedule includes other Members' schedules… According to the United States, the other schedules are 'annexes' within the

meaning of Vienna Convention Article 31(2). Article XX:3 of the GATS confirms this by providing that '[s]chedules of specific commitments shall be annexed to this agreement and shall form an integral part thereof.'"

[21] Pakistan perhaps comes closest. Its schedule contains a market access limitation for lending that states "Bound for the total volume of foreign banks' assets in Pakistan at the time of the conclusion of the Negotiations on 12 December 1997." However, this is an explicitly discriminatory cap, applying only to the assets of foreign banks. It therefore likely to have a different motivation that a non-discriminatory finance/GDP ratio.

[22] As the Secretariat wrote, "Certain size limitations apply: the merged bank may not control more than 10% of the total deposits of insured depository institutions in the United States, and there are deposit limitations at state level." See WTO Document WT/TPR/S/200/Rev.1, at 107.

[23] See WTO, "Financial Services," Background Note by the Secretariat, S/C/W/312 and S/FIN/W/73, Feb 3, 2010. "26. The Annex further specifies that if a Member allows the last two types of activities "to be conducted by its financial service suppliers in competition with a public entity or a financial service supplier", then those activities are not considered to be "services supplied in the exercise of governmental authority" and will therefore be considered as covered by the GATS. The meaning of the expression "in competition" becomes crucial in this context. For instance, financial service suppliers are often involved in statutory social security systems through, for example, the management of mandatory occupational pension funds or the supply of mandatory private insurance (e.g. to provide medical benefits and cash maternity benefits). Many of these activities may be subject to the GATS if conducted in competition among different financial service suppliers, for example in cases where, depending on the regulatory framework, the beneficiary and/or the employer are allowed to choose the pension fund manager or the insurance company that will provide the relevant service. … 39. With regard to monopolies, the Understanding adds to the disciplines imposed by Article VIII of the GATS by providing that Members must include in their schedules any existing monopoly rights in the financial services sector and shall endeavour to eliminate them or reduce their scope. This obligation also applies to the activities conducted by a public entity for the account or with the guarantee or using the financial resources of the government, which, if provided on a non-competitive basis, would normally be considered services supplied in the exercise of governmental authority and, thus, fall outside the scope of the GATS." At 7 and 11.

[24] For instance, in the U.S. Internet gambling ban WTO case, the U.S. prohibition on both U.S. *and* foreign gambling companies against offering online gambling to U.S. consumers was found to be a "zero quota" and thus violate GATS market access requirements. See, "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services - AB-2005-1 - Report of the Appellate Body," WTO Document WT/DS285/AB/R, July 4, 2005, at 88.

[25] For more on this issue, see Erich Vranes, "The WTO and Regulatory Freedom: WTO Disciplines on Market Access, Non-Discrimination and Domestic Regulation Relating to Trade in Goods and Services," *Journal of International Economic Law,* 12:4, October 2009.

[26] USTR alleges the following market access violation: "China appears to impose market access restrictions and requirements on service suppliers of other Members seeking to supply electronic payment services in China. It appears that China UnionPay ('CUP'), a Chinese entity, is the only entity that China permits to supply electronic payment services for payment card transactions denominated and paid in renminbi ('RMB') in China. Service suppliers of other Members can only supply these services for payment card transactions paid in foreign currency." But, as USTR knows, there is no such GATS sector as "electronic payment services for payment card transactions denominated and paid in renminbi ('RMB') in China." There is only "All payment and money transmission services." So, USTR doesn't allege that China has a monopoly for "All payment and money transmission services," just those "denominated and paid in RMB in China." See http://www.ustr.gov/webfm_send/2287 and http://www.ustr.gov/about-us/press-office/press-releases/2010/september/united-states-files-two-wto-cases-against-china

[27] Landon Thomas and Eric Dash, "British Bank Proposal Expected to Include Stiff Rules," *New York Times,* April 7, 2011. Available at: http://www.nytimes.com/2011/04/08/business/global/08pound.html?_r=1&pagewanted=print

[28] "Scheduling Of Initial Commitments In Trade In Services: Explanatory Note, Addendum," MTN.GNS/W/164/Add.1, Nov. 30, 1993. A 2001 update of this guide was no more definitive: "It has been pointed out that in some schedules the granting of licences has been subject to review, possibly meaning they are granted on a discretionary basis. In such a case the right to supply the service is uncertain. Therefore such entries should be avoided unless the objective criteria on which such a review is based are precisely described."

[29] Markus Krajewski, *National Regulation and Trade Liberalization in Services*, (The Hague: Klewer Law International, 2003), at 92.

[30] Council for Trade in Services - Special Session - Economic Needs Tests - Note by the Secretariat, S/CSS/W/118 (30 Nov. 2001). The preceding examples also from this document.
[31] "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services - AB-2005-1 - Report of the Appellate Body," WTO Document WT/DS285/AB/R, July 4, 2005, at para 231.
[32] Rob Garver, "Fed Rebuts Foreign Banks' Claim of New Rules' Bias," *American Banker,* April 19, 2000.
[33] "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services - AB-2005-1 - Report of the Appellate Body," WTO Document WT/DS285/AB/R, July 4, 2005, at paras 306-308.
[34] "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services - AB-2005-1 - Report of the Appellate Body," WTO Document WT/DS285/AB/R, July 4, 2005, at paras 339.
[35] The full text reads "Article VI: Domestic Regulation: 1. In sectors where specific commitments are undertaken, each Member shall ensure that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner. 2. (a) Each Member shall maintain or institute as soon as practicable judicial, arbitral or administrative tribunals or procedures which provide, at the request of an affected service supplier, for the prompt review of, and where justified, appropriate remedies for, administrative decisions affecting trade in services. Where such procedures are not independent of the agency entrusted with the administrative decision concerned, the Member shall ensure that the procedures in fact provide for an objective and impartial review. (b) The provisions of subparagraph (a) shall not be construed to require a Member to institute such tribunals or procedures where this would be inconsistent with its constitutional structure or the nature of its legal system. 3. Where authorization is required for the supply of a service on which a specific commitment has been made, the competent authorities of a Member shall, within a reasonable period of time after the submission of an application considered complete under domestic laws and regulations, inform the applicant of the decision concerning the application. At the request of the applicant, the competent authorities of the Member shall provide, without undue delay, information concerning the status of the application. 4. With a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements *do not constitute unnecessary barriers to trade in services*, the Council for Trade in Services shall, through appropriate bodies it may establish, develop any necessary disciplines. Such disciplines shall aim to ensure that such requirements are, inter alia: (a) based on objective and transparent criteria, such as competence and the ability to supply the service; *(b) not more burdensome than necessary to ensure the quality of the service; (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service*. (a) In sectors in which a Member has undertaken specific commitments, pending the entry into force of disciplines developed in these sectors pursuant to paragraph 4, the Member shall not apply licensing and qualification requirements and technical standards that nullify or impair such specific commitments in a manner which: (i) does not comply with the criteria outlined in subparagraphs 4(a), (b) or (c); and (ii) could not reasonably have been expected of that Member at the time the specific commitments in those sectors were made. (b) In determining whether a Member is in conformity with the obligation under paragraph 5(a), account shall be taken of international standards of relevant international organizations(3) applied by that Member. 6. In sectors where specific commitments regarding professional services are undertaken, each Member shall provide for adequate procedures to verify the competence of professionals of any other Member." [italics added]
[36] Ellen Gould, "The Draft GATS Domestic Regulation Disciplines – Potential Conflicts with Developing Country Regulations," South Center Analytical Note SC/AN/TDP/SV/12, October 2009. Available at: http://www.southcentre.org/index.php?option=com_content&view=article&id=1092%3Athe-draft-gats-domestic-regulation-disciplines-potential-conflicts-with-developing-country-regulations&lang=en See also: Robert Stumberg, Briefing Memo for Kay Wilkie on WPDR third draft on domestic regulation, May 28, 2007.
[37] Panagiotis Delimatsis, "Due Process and 'Good' Regulation Embedded in the GATS - Disciplining Regulatory Behaviour in Services Through Article VI of the GATS," *Journal of International Economic Law*, 10:1, 2007.
[38] The WTO's Working Party on Domestic Regulation recently explored the distinction between "necessity" tests in exception provisions like Article XIV, and obligation provisions like Article VI. Because of the absence of relevant jurisprudence on the latter, the paper largely applies the terms of reference of the former. See " 'Necessity Tests' in the WTO," Note by the Secretariat, S/WPDR/W/27/Add.1, January 17, 2011.
[39] Ellen Gould, "The Draft GATS Domestic Regulation Disciplines – Potential Conflicts with Developing Country Regulations," South Center Analytical Note SC/AN/TDP/SV/12, October 2009. Available at: http://www.southcentre.org/index.php?option=com_content&view=article&id=1092%3Athe-draft-gats-domestic-regulation-disciplines-potential-conflicts-with-developing-country-regulations&lang=en See also: Robert Stumberg, Briefing Memo for Kay Wilkie on WPDR third draft on domestic regulation, May 28, 2007.
[40] "Scheduling Of Initial Commitments In Trade In Services: Explanatory Note, Addendum," MTN.GNS/W/164/Add.1, Nov. 30, 1993.

[41] WTO, "Financial Services," WTO Document S/C/W/72, Dec. 2, 1998.
[42] We make this interpretation here, as well: http://citizen.typepad.com/eyesontrade/2011/04/reflections-on-meaning-of-prudential-language-in-the-wto.html
[43] WTO, "Financial Services," WTO Document S/C/W/72, Dec. 2, 1998.
[44] WTO, "Financial Services," WTO Document S/C/W/72, Dec. 2, 1998.
[45] WTO, "Financial Services," Background Note by the Secretariat, S/C/W/312 and S/FIN/W/73, Feb 3, 2010, at 37.
[46] WTO, "Financial Services," Background Note by the Secretariat, S/C/W/312 and S/FIN/W/73, Feb 3, 2010.
[47] Elsewhere, we've suggested a similar reading of the PMD. See http://citizen.typepad.com/eyesontrade/2011/04/reflections-on-meaning-of-prudential-language-in-the-wto.html, http://worldtradelaw.typepad.com/ielpblog/2011/05/todd-tucker-on-prudential-measures.html, http://citizen.typepad.com/eyesontrade/2011/05/postscript-on-pmd.html, http://worldtradelaw.typepad.com/ielpblog/2011/05/more-from-todd-tucker-on-prudential-regulation.html.
The practical import of this reading is that it would allow the PMD to mean something (i.e. prudential measures are excused from the Article VI disciplines), while being self-cancelling with respect to XVI-violative measures.
[48] See http://citizen.typepad.com/eyesontrade/2011/04/reflections-on-meaning-of-prudential-language-in-the-wto.html, http://worldtradelaw.typepad.com/ielpblog/2011/05/todd-tucker-on-prudential-measures.html, http://citizen.typepad.com/eyesontrade/2011/05/postscript-on-pmd.html, http://worldtradelaw.typepad.com/ielpblog/2011/05/more-from-todd-tucker-on-prudential-regulation.html.
[49] Working Group On Financial Services Including Insurance, "Note on the Meeting of 11-13 June 1990," MTN.GNS/FIN/1, July 5, 1990. Available at: http://sul-derivatives.stanford.edu/derivative?CSNID=92100236&mediaType=application/pdf
[50] "Uruguay Round Negotiations on Financial Services," House Banking, Finance and Urban Affairs Committee, Hearing Before The Subcommittee on Financial Institutions and Supervision, Regulation and Insurance, Task Force on International Competitiveness of U.S. Financial Institutions, Serial Number 101-152, July 17, 1990, with supplementary materials.
[51] WTO Dispute Settlement Body, "United States - Measures Affecting the Cross-Border Supply of Gambling and Betting Services," WTO Document WT/DS285/R, Nov. 10, 2004, at para 6.310.
[52] WTO, "Additional Commitments Under Article XVIII of the GATS," WTO Document S/CSC/W/34, July 16, 2002, at 16.
[53] Appellate Body Report, *United States – Tax Treatment for 'Foreign Sales Corporations,* WT/DS108/AB/R, Feb. 24, 2000, footnote 124 to para 111. The panel cited the previous year's Appellate Body finding in the *Canada – Aircraft* decision, which stated:
"187. We note that Article 13.1 of the DSU provides that "A Member should respond promptly and fully to any request by a panel for such information as the panel considers necessary and appropriate." (emphasis added) Although the word "should" is often used colloquially to imply an exhortation, or to state a preference, it is not always used in those ways. It can also be used "to express a duty [or] obligation". The word "should" has, for instance, previously been interpreted by us as expressing a "duty" of panels in the context of Article 11 of the DSU. Similarly, we are of the view that the word "should" in the third sentence of Article 13.1 is, in the context of the whole of Article 13, used in a normative, rather than a merely exhortative, sense. Members are, in other words, under a duty and an obligation to "respond promptly and fully" to requests made by panels for information under Article 13.1 of the DSU. 188. If Members that were requested by a panel to provide information had no legal duty to "respond" by providing such information, that panel's undoubted legal "right to seek" information under the first sentence of Article 13.1 would be rendered meaningless. A Member party to a dispute could, at will, thwart the panel's fact-finding powers and take control itself of the information-gathering process that Articles 12 and 13 of the DSU place in the hands of the panel. A Member could, in other words, prevent a panel from carrying out its task of finding the facts constituting the dispute before it and, inevitably, from going forward with the legal characterization of those facts. Article 12.7 of the DSU provides, in relevant part, that "…the report of a panel shall set out the findings of fact, the applicability of relevant provisions and the basic rationale behind any findings and recommendations that it makes." If a panel is prevented from ascertaining the real or relevant facts of a dispute, it will not be in a position to determine the applicability of the pertinent treaty provisions to those facts, and, therefore, it will be unable to make any principled findings and recommendations to the DSB."
[54] Informal translation into English of dissenting vote of Dr. José María Chillón Medina in International Center for the Settlement of Investment Disputes, *Nations Energy Inc. et. al. v. Panama,* Award, Nov. 24, 2010, at paragraphs 4-5. Available at: http://ita.law.uvic.ca/documents/NationsResourcesVPanama_Award.pdf
[55] Ibid, at paragraphs 66-71.

[56] Communication from Barbados, "Unintended Consequences of Remedial Measures taken to correct the Global Financial Crisis: Possible Implications for WTO Compliance," Committee on Trade in Financial Services Document, JOB/SERV/38, Feb. 18, 2011. Available at: http://www.coc.org/system/files/BarbadosSubmission.pdf
[57] Edward Wyatt, "With Issa Leading, Oversight Panel Eagerly Begins Its Work," *New York Times,* Jan. 26, 2011. Available at: http://www.nytimes.com/2011/01/27/us/politics/27issa.html?_r=1
[58] Meera Louis and Jurjen van de Pol, "EU Finance Ministers to Resist Obama Plans for Banking Overhaul," Bloomberg, Feb. 15, 2010. Available at: http://www.bloomberg.com/apps/news?pid=20601109&sid=ad9u.o9vgBiQ&pos=10# Europeans have already raised concerns in the past, even about how *removal* of the firewalls was affecting them. See: Rob Garver, "Foreign Banks Say U.S. Reforms Leave Them at a Disadvantage," *American Banker,* March 16, 2000.
[59] William Drake and Kalypso Nicolaidis, "Ideas, Interests, and Institutionalization: 'Trade in Services' and the Uruguay Round," *International Organization,* 46: 1, Winter 1992, at 79
[60] It read: "the application of national treatment by countries having an institutional separation of banking and securities activities tends to be viewed as an obstacle by institutions from universal banking countries and other countries which do not maintain such a separation. As with market access, therefore, national treatment may not be altogether unrelated to considerations of bilateral or plurilateral reciprocity… Virtually all impediments to market access in banking and securities-related services take the form of restrictions on entry and operations. Improved market access would enable foreign financial institutions to supply services in a given market either directly from abroad or through a local presence. This could refer both to access to activities (through licensing or authorization) as well as to the exercise of activities (through operating conditions)." GATT, "Trade in Financial Services," MTN.GNS/W/68, September 1989, at 9, and 12-13.
[61] GATT, "Trade in Financial Services," MTN.GNS/W/68, September 1989, at 15-16.
[62] Full quote: "The concept of market access could also be useful in focusing on problems that would not be resolved by national treatment; for example, problems of access arising out of the regulatory separation of financial activities. He said that there were several possible ways to define national treatment, noting that in the case of financial services, it seemed difficult to consider this concept in isolation from market access and progressive liberalization. While national treatment would certainly be a key concept of itself in liberalizing trade, it would not guarantee that reasonable access to financial markets was provided. Therefore, it could serve as a key building block, but it was not sufficient."
[63] At the same meeting, the U.S. undercut its own position by arguing against line of business separations within the insurance market: "Even though the regulatory frameworks applying to financial services were very different among countries, provisions in the framework agreement regarding the regulatory situation of this sector, and many others, should be consistent with other commitments included in the agreement. In the case of insurance services, domestic regulations frequently eliminated the most dynamic elements of competition such as price and product differentiation. Discriminatory licensing could exclude competitive firms from certain lines of insurance business, thus limiting the scope of product differentiation in a particular market. Competitive firms might also be prevented from offering various types of services and greater protection to persons and/or other firms at a lower cost to the consumer than that prescribed through price controls."
[64] All preceding quotes from "Note On The Meeting Of 18-22 September 1989," MTN.GNS/25, October 1989.
[65] Timothy Geithner, "Uruguay Round / Financial Services: U.S. Measures in the Banking and Securities Sectors," Treasury Department Memo, April 20, 1990. On file with Public Citizen.
[66] Timothy Geithner, "Uruguay Round / Financial Services: U.S. Measures in the Banking and Securities Sectors," Treasury Department Memo, April 20, 1990. On file with Public Citizen.
[67] This was revealed in many of the FOIA documents we have obtained. For example, the draft GATS market access provision from October 8, 1989 read: "4.1: With respect to provision of any covered service, each Party within its territory shall permit persons of any other Party to establish or expand a commercial presence for the provision of a covered service (including, inter alia, acquisition of an existing company, establishment of a new company, or joint venture or affiliation with an existing company) on a basis no less favorable than that accorded in like circumstances to its own persons."
[68] Keith R. Fisher, "Reweaving the Safety Net: Bank Diversification Into Securities and Insurance Activities," *Wake Forest Law Review,* 27, 1992, at 140.
[69] Sarah A. Wagman, "Laws Separating Commercial Banking and Securities Activities as an Impediment to Free Trade in Financial Services: A Comparative Study of Competitiveness in the International Market for Financial Services," *Michigan Journal of International Law,* 15, 1993, at 1027.

[70] "Illustrative List of Barriers Identified in the United States," Memo from Mexico, undated, on file with Public Citizen.
[71] "Uruguay Round Negotiations on Financial Services," House Banking, Finance and Urban Affairs Committee, Hearing Before The Subcommittee on Financial Institutions and Supervision, Regulation and Insurance, Task Force on International Competitiveness of U.S. Financial Institutions, Serial Number 101-152, July 17, 1990, with supplementary materials, at 9-11.
[72] Memo from CME Staff to U.S. Treasury staff, dated July 1991. On file with Public Citizen.
[73] "Communication from the European Communities," MTN.GNS/FIN/W/1, July 10, 1990, at 6. Available at: http://sul-derivatives.stanford.edu/derivative?CSNID=92100245&mediaType=application/pdf
[74] Jan Kregel, "No Going Back: Why We Cannot Restore Glass-Steagall's Segregation of Banking and Finance," Levy Economics Institute of Bard College Public Policy Brief No. 107, 2010.
[75] "Communication From United States Of America: Conditional Offer of the United States of America, Concerning Initial Commitments," MTN.GNS/W/112, November 13, 1990. Available at: http://sul-derivatives.stanford.edu/derivative?CSNID=92110260&mediaType=application/pdf
[76] This language broadly corresponded to the draft language for the "Elements of a Financial Service Annex," which dated from October 1990 in the GATT Working Group on Financial Services Including Insurance – liberated through FOIA to Public Citizen. These rules would later be adapted and split off into the Understanding.
[77] "Draft Final Act Embodying The Results Of The Uruguay Round Of Multilateral Trade Negotiations," MTN.TNC/W/FA, December 20, 1991. Available at: http://sul-derivatives.stanford.edu/derivative?CSNID=92130093&mediaType=application/pdf
[78] Communication From The United States Of America: Revised Conditional Offer of the United States of America Concerning Initial Commitments Revision," MTN.GNS/W/112/Rev.1, January 21, 1992. Available at: http://sul-derivatives.stanford.edu/derivative?CSNID=92130110&mediaType=application/pdf
[79] "Communication From The United States Of America: Revised Conditional Offer of The United States in Banking and Other Financial Services (Excluding Insurance) Based on the Understanding in Financial Services," MTN.GNS/W/112/Rev .1/Add.1, March 26, 1992. Available at: http://sul-derivatives.stanford.edu/derivative?CSNID=92130150&mediaType=application/pdf
[80] "Communication From The United States Of America: Revised Conditional Offer of the United States of America, Concerning Initial Commitments, Revision," MTN.GNS/W/112/Rev.2, October 1, 1993. Available at: http://sul-derivatives.stanford.edu/derivative?CSNID=92140054&mediaType=application/pdf
[81] "Communication From The United States Of America: Draft Final Schedule of the United States of America concerning Initial Commitments," MTN.GNS/W/112/Rev.3, December 7, 1993. Available at: http://sul-derivatives.stanford.edu/derivative?CSNID=92150007&mediaType=application/pdf
[82] "The United States Of America, Schedule of Specific Commitments," GATS/SC/90, April 15, 1994, at 63.
[83] "The United States Of America, Schedule of Specific Commitments, Supplement 1," GATS/SC/90/Suppl.1, July 28, 1995, at 16-17.
[84] Article XVI(1) reads: "With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its Schedule. [Footnote: If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(a) of Article I and if the cross-border movement of capital is an essential part of the service itself, that Member is thereby committed to allow such movement of capital. If a Member undertakes a market-access commitment in relation to the supply of a service through the mode of supply referred to in subparagraph 2(c) of Article I, it is thereby committed to allow related transfers of capital into its territory.]" As noted in the following footnote, the U.S. believed that its 1994 schedule would have allowed Article XVI(1) footnote-inconsistent transfer-restrictions.
[85] For instance, a September 15, 1997 internal memorandum liberated through FOIA is entitled "Replies to Japanese Questions on the U.S. Offer in Financial Services." Japan apparently asked the United States:

> "What is the implication of the reservation in Paragraph 1 of the headnote in B. Financial Services in the U.S. offer? Does this mean that the U.S. would be free to take any of the measures prohibited by Paragraph 2 of Article XVI?"

USTR responded that:

"The headnote indicates that the United States has undertaken its market access commitments in accordance with the Understanding rather than with paragraph 2 of Article XVI.

"By undertaking market access commitments pursuant to the Understanding, the U.S. has committed to provide meaningful market access, including with respect to our recently liberalized interstate banking market. In any case where measures are maintained that are inconsistent with these commitments, the U.S. has taken reservations in its schedule.

"The U.S. does <u>not</u> regard itself as free to take any measures prohibited by paragraph 2 of Article XVI. With the exception of our dual banking system, the commitments we have undertaken under the Understanding require us to reserve most of the same measures we would have to reserve under paragraph 2 of Article XVI.

> "For example, we have taken reservations for juridical form where a particular state does not offer foreign banks widely available choices of form (such as branches or representative offices).
>
> "As we have already explained, the major differences we see between paragraph 2 of Article XVI and the Understanding is with respect to implications for interstate expansions for foreign banks that have already established a U.S. presence. [For greater detail, see the response to questions on our headnote 1 from the EU.]

Japan then asked,

"According to the Understanding on Commitments in Financial Services ('the Understanding'), a participant country can take on specific commitments on the basis of an alternative approach to that covered by the provisions of Part III – which includes Article XVI – of the Agreement on the condition that this approach does not conflict with the provisions of the Agreement (see Preamble (I) of 'the Understanding'). Therefore, is it the case that, despite the reservation in Paragraph 1 of the headnote, the U.S. would still be obliged to conform to Paragraph 2 of Article XVI? If not, please explain the legality of not conforming to Paragraph 2 of Article XVI; is the headnote consistent with Paragraph 1 of Article XX of the GATS, which requests each schedule to specify terms, limitations and conditions on market access?"

USTR responded that:

"We note that there are a number of issues relating to the significance of headnotes and footnotes in GATS schedules that remain unanswered. It is also apparent that countries have adopted differing approaches to scheduling headnotes and footnotes. We believe that it would be useful and important to try to achieve some uniformity of understanding on these issues.

"Nevertheless, it is important to note that Article XVI (market access) and XVII (national treatment) are all specific commitment provisions and NOT general obligations of the GATS. This means that it is up to each country to determine if or to what extent it undertakes the specific commitments of these articles. In this way, these articles differ from articles such as Article III (Transparency) or V (Economic Integration). Although Article II (MFN) is a general obligation, it provides specifically for a method by which exemptions can be taken from its provisions.

"In our view, the GATS makes it possible for any country, including the United States, to choose not to undertake any commitments under Articles XVI and XVII.

"That, of course, is not the U.S. intent, and we have therefore specifically committed the U.S. to the obligations of the Understanding, except where reservations have been undertaken. The reason we have not scheduled under the paragraph 2 of Article XVI is not to avoid market access commitments, but rather to avoid raising any questions with respect to our dual system. Although this system is complicated and frequently difficult to comprehend, it remains a salient feature of banking in the United States."

Japan then asked:

> "What difference would it make if the headnote were deleted? Would the U.S. have to list the existing measures that do not conform with Paragraph 2 of Article XVI? Would your please provide us with specific examples or cases that explain why a headnote is needed?"

USTR responded that:

> "Paragraph 1 of the headnote is needed only to the extent that it notifies that the United States is scheduling under the Understanding rather than under paragraph 2 of Article XVI of the Agreement. The second sentence of paragraph 1 of the U.S. headnote, which relates to the additional U.S. commitment under paragraph 1 of the Article XVI of the Agreement could be deleted, but this would reduce the U.S. commitment by eliminating the commitment contained in footnote 8 to paragraph 1 of Article XVI concerning transfers of capital.
>
> "As explained in the answer to the last question, since the U.S. has taken no commitments under paragraph 2 of Article XVI, it is not obligated to list measures that do not conform with that paragraph. This is true regardless of whether or not the U.S. retains the headnote."

The absence of Glass-Steagall as a possible conflict with Article XVI(2) is interesting. USTR's interpretation that the Understanding requires elimination of all Article XVI(2)-inconsistent policies except for the U.S.' "dual banking system" (i.e. state and federal chartering) suggests that USTR either, a) believed that Glass-Steagall was prohibited by both the Understanding and Article XVI(2) (in which case the headnotes in the early U.S. schedules that referenced only the market access commitments of the Understanding would not have provided a useful carve-out for Glass-Steagall), or b) believed that Glass-Steagall was not implicated by either. As this memo hopefully shows, that latter interpretation does not seem to have strong support in the literature and negotiating history.

Also enclosed in the FOIA response was an August 22, 1997 memorandum from USTR Official 1 to Treasury Official 1, which mentions that the Japanese have raised questions about the U.S. offer. It is clear from the memo that USTR opposed the inclusion of the headnote, but was asked to defend it by Treasury. USTR Official 1 writes:

> "I have contended that, in fact, our obligation to para. 5 of the Understanding, is far more sweeping when taking account of the definition of commercial presence in the Agreement. But again, I can't really explain why we excluded XVI.2."

USTR Official 1 began an email chain on that same day with USTR Officials 2 (who is now a prominent lobbyist on financial services trade with Citigroup, the firm that most benefited from Glass-Steagall repeal) and 3:

> "The friction we had with Japan over our offer has spilled over to other delegations, and I must confess [REDACTED]. I thought I would engage [Treasury Official 1] on this, since [he] is a pretty good head and has a good legal grasp of the Agreement. Indeed, as my noted to him suggests, [REDACTED], which Treasury finds important. But, for the moment, I am without some answers, and I am getting a lot of questions. I think you would agree that we don't need this extra baggage, no matter what people's motivations are."

On September 10, USTR Official 1 followed up by asking his staff to follow up with Treasury, and saying: "There is no reason why we should have to contend with an issue such as this." USTR Official 3 wrote back, saying: "I just had a brief conversation with [Treasury Official 1] on this, and must confess I've never focused on – and am surprised by – [REDACTED]. He's sending me some materials which may help explain things. *How we interp. [sic] Art. XVI obviously has systemic implications*." [italics added]

A later September 29 email by USTR Official 1 to USTR Officials 2 and 3 complained about "Treasury's bizarre logic" and the "terrible lawyering over at the Treasury (in this case, dear [Treasury Official 2])." He recounted: "[REDACTED] *the negotiating history is that the EC pressed us to do something on interstate branching; we, of* *course, could not; and the resulting compromise was this best endeavors language. (Same with the Glass Steagall related provisions of para. 10*).” [Italics added]

As this email chain shows, USTR and Treasury had great uncertainty about what specific provisions of the GATS require, but noted that how USTR chose to spin the U.S. position on Article XVI “obviously has systemic implications.”

As this memo shows, the notion that Glass-Steagall is only captured by the “shall endeavor” language of Understanding Article B(10) seems to be misplaced. In any case, as we note above, “shall endeavor” language is not completely devoid of discipline either.

On October 10, USTR Official 3 wrote to USTR Official 1, saying “I got a draft revision from [Treasury Official 1] earlier this week. From a prior conversation w/ [him], their heart now appears to be in the right place [REDACTED].” He added that the draft to “Reference to non-applicability of XVI:2 is dropped [REDACTED].” USTR Official 1 responded that “Glad to know Treasury has finally seen the light, which will make life slightly easier in the coming weeks ahead in finservices.”

As this email chain makes clear, USTR was looking primarily out for U.S. offensive interests, and were most interested on getting Treasury to sign off on an interpretation on the GATS implications of for U.S. domestic consumption that would advance that objective.

Heavily redacted minutes from a later October 14 meeting between USTR Official 3, Treasury Official 1, Federal Reserve Board Official 1 and Hamid Mamdouh (WTO Secretariat) reveal that Mamdouh opined widely on the U.S. headnotes, and agreed with certain points that were made. However, the minutes are so completely redacted that it is impossible to know more of what was discussed.

USTR staff discussed further revisions to the U.S. offer on November 4-5, where USTR Official 3 indicated he was having success in convincing Treasury Official 1 of USTR’s views. USTR Official 1 added: “Thanks for that clarification … I guess I draw the same conclusion to all of this: the Understanding sucks!”

In summary, at several points along the negotiations in the 1990s, there was uncertainty among U.S. and Japanese negotiators about the exact scope of the Article XVI disciplines, their relationship with the provisions of the “sucky” Understanding, and whether they would apply to interstate branching – a non-quota, non-monopoly, non-economic needs tests, non-quantitative ceiling domestic regulation. What level of uncertainty then for Glass-Steagall, which had many of these features?

[86] “Communication From The United States Of America, Revised Conditional Offer on Financial Services, Revision,” S/FIN/W/12/Add.5/Rev.1, December 9, 1997.
[87] Committee on Trade in Financial Services - Report of the Meeting Held on 5 June 1997 - Note by the Secretariat
[88] “Communication From The United States Of America, Revised Conditional Offer on Financial Services, Revision,” S/FIN/W/12/Add.5/Rev.2, December 12, 1997, at 27.
[89] WTO, “Additional Commitments Under Article XVIII of the GATS,” WTO Document S/CSC/W/34, July 16, 2002, at 16.
[90] WTO, “Financial Services,” WTO Document S/C/W/72, Dec. 2, 1998.
[91] “Statement by Secretary Rubin and Ambassador Barshefsky Regarding the Successful Conclusion of the WTO Financial Services Negotiations,” Dec. 13, 1997.
[92] Press Briefing by Charlene Barshefsky, Dan Tarullo, and Larry Summers, Dec. 18, 1997.
[93] “25. The representative of the United States announced that the Financial Modernization Bill had been signed on 12 November 1999. That bill represented the reform of the laws covering the US financial sector in a comprehensive manner. The greatest benefit of the Gramm-Leach-Bliley Act was that it repealed restrictions that had prevented any financial services firm from offering a full range of products and which in some cases forced foreign firms to adjust their legal structures and scope of activities when establishing in the United States. The new legislation eliminated many federal laws regarding to the affiliations among banks and securities firms and insurance companies. It also created new statutory mechanisms for establishing financial holding companies whose subsidiary depository institutions were required by the law to be well capitalized and well managed. Those holding companies

could engage in a statutorily provided list of financial activities including insurance, securities underwriting agency activities and so forth. He noted that the reform responded directly to what could be characterized as sustained foreign criticism of US financial regulation over the years, but it was undertaken for its own economic benefits in the market. As regards foreign institutions applying for licenses as financial holding companies and other aspects of the Act, the new legislation instructed the Federal Reserve to apply comparable capital and management standards to such foreign institutions. Since November, a series of regulations had been issued and as of that date 13 foreign institutions had been approved as financial holding companies. 26. The representative of the European Communities welcomed the announcement by the United States. He noted, however, that there was some concern in relation to an interim rule by the Federal Reserve concerning the applications by foreign firms to become financial holding companies. The concern related to the application of different criteria to determine when a financial holding company was considered well capitalized and well managed. It was hoped that this matter would be resolved when the Federal Reserve issued its final rule." See Committee on Trade in Financial Services, "Report on the Meeting Held on 13 April 2000: Note by the Secretariat," WTO Document S/FIN/M/25, May 8, 2000. Thanks to Ellen Gould for this example.

[94] Committee on Trade in Financial Services, "Report Of The Meeting Held On 2 December 2002: Note by the Secretariat," WTO Document S/FIN/M/38, Feb. 11, 2003. Similar comments were also made in S/FIN/M/32, S/FIN/M/33, S/FIN/M/34, and S/FIN/M/35 over 2000-2002. Thanks to Ellen Gould for this example.

[95] "Communication From The United States, Initial Offer," TN/S/O/USA, April 9, 2003.

[96] National Bank Act of 1864, Chapter 106, 13 Stat. 99, enacted June 3, 1864; signed into law in 1865.

[97] *California Bank v. Kennedy* 167 U.S. 362, 370-371 (1897) and *Logan County Nat'l Bank v. Townsend*, 139 U.S. 67, 68 *1891). Cited in Essential Information / Consumer Education Foundation Joint Report, "Sold Out: How Wall Street and Washington Betrayed America," March 2009, at 23.

[98] Federal Reserve Act of 1913, P.L. 63-43, 38 STAT. 251, 12 USC 221, enacted December 23, 1913 as H.R. 7837.

[99] Essential Information / Consumer Education Foundation Joint Report, "Sold Out: How Wall Street and Washington Betrayed America," March 2009, at 24.

[100] The Section went on to say: "Provided, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe, but in no event (1) shall the total amount of any issue of investment securities of any one obligor or maker purchased after this section as amended takes effect and held by the association for its own account exceed at any time 10 per centum of the total amount of such issue outstanding, but this limitation shall not apply to any such issue the total amount of which does not exceed $100,000 and does not exceed 50 per centum of the capital of the association, nor (2) shall the total amount of the investment securities of any one obligor or maker purchased after this section as amended takes effect and held by the association for its own account exceed at any time 15 per centum of the amount of the capital stock of the association actually paid in and unimpaired and 25 per centum of its unimpaired surplus fund. As used in this section the term 'investment securities ' shall mean marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association of any shares of stock of any corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations issued under authority of the Federal Farm Loan Act, as amended, or issued by the Federal Home Loan Banks or the Home Owners' Loan Corporation : Provided, That in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the association actually paid in and unimpaired and 15 per centum of its unimpaired surplus. The restrictions of this section as to dealing in investment securities shall take effect one year after the date of the approval this Act."

[101] Banking Act of 1933 (Glass-Steagall Act), P.L. 73-66, 48 STAT. 162, (1933). H.R. 5661. The section goes on to read: ""For every violation of this section the member bank involved shall be subject to a penalty not exceeding $1,000 per day for each day during which such violation continues. Such penalty may be assessed by the Federal Reserve Board, in its discretion, and, when so assessed, may be collected by the Federal reserve bank by suit or otherwise. If any such violation shall continue for six calendar months after the member bank shall have been warned by the Federal Reserve Board to discontinue the same, (a) in the case of a national bank, all the rights, privileges, and franchises granted to it under the National Bank Act may be forfeited in the manner prescribed in

section 2 of the Federal Reserve Act, as amended (U.S.C., title 12, secs. 141, 222-225, 281-286 and 502), or, (b) in the case of a State member bank, all of its rights and privileges of membership in the Federal Reserve System may be forfeited in the manner prescribed in section 9 of the Federal Reserve Act, as amended (U.S.C., title 12, secs. 321-332).

[102] Essential Information, at 26.

[103] Bank Holding Company Act of 1956, P.L. 84-511, 70 STAT. 133.

[104] Sydney J. Key, "Is National Treatment Still Viable? U.S. Policy in Theory and Practice," Board of Governors of the Federal Reserve System, International Finance Discussion Papers Number 385, September 1990, at 24.

[105] Key, at 25.

[106] Key, at 40.

[107] As Essential Information explained, "In furtherance of the Fed's authority under BHCA, the Supreme Court in 1971 ruled that courts should defer to regulatory decisions involving bank holding company applications to acquire non-bank entities under the BHCA loophole. As long as a Federal Reserve Board interpretation of the BHCA is "reasonable" and "expressly articulated," judges should not intervene, the court concluded. The ruling was a victory for opponents of Glass Steagall because it increased the power of bank-friendly regulators. It substantially freed bank regulators to authorize bank holding companies to conduct new non-banking activities without judicial interference, rendering a significant blow to Glass-Steagall. As a result, banks whose primary business was managing customer deposits and making loans began using their bank holding companies to buy securities firms. For example, Bank-America purchased stock brokerage firm Charles Schwab in 1984. The Federal Reserve had decided that Schwab's service of executing buy and sell stock orders for retail investors was "closely related to banking" and thus satisfied requirements of the BHCA. In December 1986, the Fed reinterpreted the phrase "engaged principally," in Section 20 of the BHCA, which prohibited banks from affiliating with companies engaged principally in securities trading. The Fed decided that up to 5 percent of a bank's gross revenues could come from investment banking without running afoul of the ban. Just a few months later, in the spring of 1987, the Fed entertained proposals from Citicorp, J.P Morgan and Bankers Trust to loosen Glass-Steagall regulations further by allowing banks to become involved with commercial paper, municipal revenue bonds and mortgage-backed securities. The Federal Reserve approved the proposals in a 3-2 vote. One of the dissenters, then-Chair Paul Volcker, was soon replaced by Alan Greenspan, a strong proponent of deregulation. In 1989, the Fed enlarged the BHCA loophole again, at the request of J.P. Morgan, Chase Manhattan, Bankers Trust and Citicorp, permitting banks to generate up to 10 percent of their revenue from investment banking activity. In 1993, the Fed approved an acquisition by a bank holding company, in this case Mellon Bank, of TBC Advisors, an administrator and advisor of stock mutual funds. By acquiring TBC, Mellon Bank was authorized to provide investment advisory services to mutual funds. By the early 1990s, the Fed had authorized commercial bank holding companies to own and operate full service brokerages and offer investment advisory services. Glass Steagall was withering at the hands of industry-friendly regulators whose free market ideology conflicted with the Depression- era reforms." At 27-28.

[108] Key, at 30-31.

[109] Financial Crisis Inquiry Commission, "The Financial Crisis Inquiry Report," January 2011, at 54-55. Available at: http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf

[110] Financial Crisis Inquiry Commission, "The Financial Crisis Inquiry Report," January 2011, at 137-139. Available at: http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf

[111] Financial Crisis Inquiry Commission, "The Financial Crisis Inquiry Report," January 2011, at 380. Available at: http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf