

## **Finance Watch response to the online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP)**

*Brussels, 8 July 2014*

The detailed questionnaire is not reported in the present document. The consultation document, which includes detailed questions and annex, is available for download on the European Commission's website: <http://trade.ec.europa.eu/doclib/html/152280.htm>

### **In short**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

*Finance Watch is an independent, non-profit public interest association dedicated to making finance work for society. It was created in June 2011 to be a citizen's counterweight to the lobbying of the financial industry and conducts technical and policy advocacy in favour of financial regulations that will make finance serve society.*

*Its 70+ civil society members from around Europe include consumer groups, trade unions, housing associations, financial experts, foundations, think tanks, environmental and other NGOs. To see a full list of members, please visit [www.finance-watch.org](http://www.finance-watch.org).*

*Finance Watch was founded on the following principles: finance is essential for society and should serve the economy, it should not be conducted to the detriment of society, capital should be brought to productive use, the transfer of credit risk to society is unacceptable, and markets should be fair and transparent.*

*Finance Watch is independently funded by grants from charitable foundations and the EU, public donations and membership fees. Finance Watch has received funding from the European Union to implement its work programmes. There is no implied endorsement by the EU or the European Commission of Finance Watch's work, which remains the sole responsibility of Finance Watch. Finance Watch does not accept funding from the financial industry or from political parties. All funding is unconditional, vetted for conflicts of interest and disclosed online and in our annual reports. Finance Watch AISBL is registered in the EU Joint Transparency Register under registration no. 37943526882-24.*

## General assessment (Question 13 of the questionnaire)

We believe that the EC is not providing the general public with balanced information when it comes to the potential impacts of TTIP in general and investor protection mechanisms in particular. For example, no information is provided on regulations that could be challenged by foreign investors; on the approximate amounts of claims against states based on past experiences; on what could be the impact of these fines on public finances, etc... We do hope that the ongoing Sustainability Impact Assessment commissioned by the EC (which is planned to cover financial services) will help answer these questions and that the EC will communicate in a transparent manner on the risks posed by investor protection mechanisms in TTIP.

Finance Watch is of the view that TTIP in general, and provisions related to investor protection and ISDS in particular, bring no value from a public interest standpoint when it relates to financial services, whereas the risks are high (see LSE Enterprise, 2013, "Costs and benefits of an EU-USA investment protection treaty").

Further investor protection mechanisms **are not needed**:

- The EU and the US have arguably among the most developed and stable legal environments in the world. There are **no issues about access to justice to justify the introduction of ISDS**. ISDS give unjustified rights to a specific class of stakeholders without related obligations.
- **ISDS are not a necessary provision of free trade agreements (FTAs)**. As an example, ISDS was removed from the investment chapter of the 2004 FTA between Australia and the USA.
- The **impact of investment protection clauses on foreign direct investment (FDI)**, presented as the main rationale for the introduction of ISDS is not supported by evidence (see WTO report, 2010, "Do trade and investment agreements lead to more FDI?"). And the Advisory Scientific Committee of the ESRB recently ("Is Europe overbanked?", 2014) and many others demonstrate that EU and US financial services are already **oversized**, challenging the assumption that developing the sector will result in social benefits.

On the other hand, the inclusion of financial services in TTIP as a whole, and ISDS in particular, involves **many risks**:

- Everything else being equal, it would **feed a race to the bottom in financial regulation**, and this despite the mitigating measures proposed by the Commission. This seems inevitable given the terms of the mandate that has been given by the Council to the Commission (see [FW evidence to ECON](#), March 2014).
- Looking forward, a "**regulatory chill**" is inevitable: regulators and policymakers would be constrained by TTIP in their ability to propose and implement the rules necessary to make finance better serve society. Such a regulatory chill would occur even if ISDS were dropped from TTIP.

- The **potential costs of investors' claims against states could have a significant impact on public finances**, especially in the financial sector where the amounts at stake are huge (as illustrated by the size of the sector and the amounts of FDI at stake).
- TTIP in general and ISDS in particular risk **increasing the already considerable influence of the financial sector on the regulatory process** (see CEO, 2014, "The Fire Power of the financial lobby").

We cannot take the risk of damaging the fragile progress achieved since the crisis in reforming the financial system, or of limiting the scope, impact and efficiency of future regulation.

Given that these comments are based on the EC approach as included in the CETA agreement, **Finance Watch also calls for a removal of ISDS from CETA.**

The Commission repeatedly mentioned that it was "executing the instructions of the 28 member states" as provided by the negotiation mandate. **Finance Watch therefore calls for a revision to this mandate.**

## **A. Substantive investment protection provisions**

### **Question 1: Scope of the substantive investment protection provisions**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

### **Question 2: Non-discriminatory treatment for investors**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

### **Question 3: Fair and equitable treatment**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

### **Question 4: Expropriation**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation.

Whereas we do not see the added value of introducing ISDS between the EU and the US, which both enjoy strong judicial systems, we see a lot of risks, which the specific provisions contemplated by the Commission in relation to expropriation are not enough to mitigate – and could even worsen. Indeed, based on the wording of the annex, we understand that tribunal interpretations and decisions against regulatory policies will be allowed - an unjustified bias for private interests. In particular, in light of the global financial crisis and regulatory responses to it, we can foresee situations where arbitration decisions about expropriation could be detrimental to the public interest:

*First*, expropriation is defined not only as direct expropriation but also as **indirect expropriation** (a measure that would have an effect equivalent to expropriation). Given the wording of the text provided in the annex to the consultation, we see no guarantee that, for example in a financial crisis, an emergency public decision leading to the write-down of securities held by private investors in banks would not lead to a valid claim. In fact, the text gives a broad definition of indirect expropriation and suggests “a case-by-case, fact-based inquiry” (presumably by arbitrators) that would consider among other factors “the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations”. Such write-downs could lead to significant claims. As an illustration, the Bank Recovery and Resolution Directive (BRRD) which takes effect in 2016 includes bail-in mechanisms that require resolution authorities to impose a portion of losses on private investors in case of a bank failure. Given the experience of the 2008 crisis where taxpayers were called on to absorb private losses, the objective of such rules is quite rightly to avoid bail-out and protect taxpayers’ money. While the BRRD has its weaknesses (see [FW analysis](#)), we cannot allow such rules to be challenged by private investors.

*Second*, the Commission states that “non-discriminatory measures taken for legitimate public purposes [...] cannot be considered equivalent to an expropriation” but adds that this is “unless they are manifestly excessive in light of their purpose”. But how would “**manifestly excessive**” be assessed and by whom? How much would public interest weigh in this assessment? We can doubt that arbitrators would put public interest first as it is not their mandate. This poses an additional risk to governments’ freedom to take decisions in accordance with the public interest, as those decisions could lead to financial compensation being imposed – in essence: further transfers of wealth from taxpayers to (foreign) investors.

Finance Watch therefore considers that the fundamental risks (see in particular our response to question 13 of the present consultation) embedded in the introduction of ISDS remain despite the proposed provisions.

### **Question 5: Ensuring the right to regulate and investment protection**

Given the strong EU and US judicial systems, **there is no need** to grant private investors further protection and specific courts. Furthermore, we see **no reason to grant foreign investors more rights** than any other natural or legal person. Finally, **ISDS risk** undermining the public

interest content of existing and future financial regulation, while the proposed mitigation to protect the 'right to regulate' is too weak to tackle these fundamental concerns.

*First*, preventing investors from asking for the repeal of a measure is not enough; it is also deeply problematic to allow investors to claim **financial compensation** if the value of their investment decreases due to democratically approved regulation. In our view, this would put investors above the law. Regulation is designed to protect public interest precisely to avoid what happened as a result of the absence of effective financial regulation over the past 20 years: a privatization of profits and a socialization of losses. No European court imposed compensation measures on the financial industry and one would expect public authorities to look for mechanisms to address this failure rather than focusing on granting even more protection to the interests of private investors.

Past and open cases show that **financial compensation** claimed by investors can amount to billions. Such compensations alone can discourage ambitious regulation, as policy makers will necessarily consider the potential extra cost for taxpayers in case a claim were upheld by an arbitration court.

*Second*, the conditions of the **prudential carve-out** are unclear and will not preserve the EU's ability to regulate in the best interest of citizens. As provided in the text referred to in the annex, the carve-out is restrictive and could lead to unfavourable interpretation from a public interest perspective:

- The **scope of the prudential carve-out** cannot guarantee that essential pieces of financial regulation will be exempted. The recent EC proposal for a structural reform of banks (a key missing piece of EU bank regulation) has objectives that include (among others) avoiding resource misallocation, encouraging real economy lending and reducing conflicts of interest. Such legitimate objectives and their related regulatory provisions could be challenged and would not be protected by the prudential carve-out, which relates only to measures ensuring the "integrity and stability" of the system.
- The prudential carve-out is weakened by the provision that "**measures shall not be more burdensome than necessary to achieve their aim**". Not only will the burden of proof of 'non-excessiveness' fall upon public authorities, but one can also doubt that such a vague formulation will leave policy makers clear from any potential challenge by investors on much-needed financial regulation.
- The prudential carve-out allows Parties to prohibit a service or activity but not if the prohibition applies "**to all financial services or to a complete financial services subsector, such as banking**". How would this apply to rules with an intended sectorial effect, such as the proposed ban on proprietary trading at deposit-taking banks?

*Third*, the proposed temporary safeguards for "exceptional circumstances" are of limited use because they would not apply to emergency regulatory measures, for example steps taken in a financial crisis (e.g. haircuts imposed to investors to protect public finances).

Finance Watch is of the view that, despite intense regulatory work since 2008, a lot remains to be done to protect citizens from future financial crisis. Past and future financial regulation should

not be subject to direct legal challenge by private investors. Despite the mitigating measures proposed, much-needed regulation might be challenged and states will fear future financial claims. This will likely lead to lower regulatory standards, in other words a “regulatory chill”. **Risks are therefore high from a public interest standpoint.**

## B. Investor-to-State dispute settlement (ISDS)

### Question 6: Transparency in ISDS

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

The European Commission (EC) suggests several mitigation mechanisms for an improved transparency of ISDS mechanisms compared to the general practice for such private arbitration courts. Finance Watch is of the view that these mechanisms do not solve the major issues posed by ISDS, as mentioned above and in our reply to question 13.

In particular we would oppose the following arguments in the EC approach:

*First*, the EC states that “the lack of openness has given rise to concern and confusion with regard to the causes and potential outcomes of ISDS disputes”. Whereas this statement is true to a certain extent, **lack of transparency is only one of many issues posed by ISDS**, and there are enough cases in the public domain to enable the public to have a good idea of the risks arising from such private arbitration courts – including, as mentioned above: regulatory chill, and the significant impact on public finances if a court awards compensation against a state (see our answers to questions 5 and 13).

*Second*, the **introduction of private arbitration courts**, which will allow foreign investors to sue EU member states for compensation, **risks increasing the already considerable influence** of the financial sector on the regulatory process, **while worsening the problem of lobby transparency**. This issue is of a particular importance to Finance Watch, which was created a few years after the crisis with to the aim of bringing more balance in the public debate over financial regulation, largely dominated by the financial industry. In particular, we are worried that it could **import the US litigation culture into the EU** (see footnote 7 of the recent article by CEO and SOMO “Leaked document shows EU is going for a trade deal that will weaken financial regulation”, which provides with examples of financial lobby associations suing the US Government on specific pieces of financial regulation).

As lawyer Peter Kirby puts it (re: investor rights in trade agreements): [ISDS is] “a lobbying tool in the sense that you can go in and say, ‘Ok, if you do this, we will be suing you for compensation.’ It does change behaviour in certain cases.” (See CEO article: “Still not loving ISDS”)

*Third*, even if the stated objective of the EC is to introduce as a basic principle the fact that “all documents [supporting ISDS cases] will be made publicly available”, the wording provided in the annex makes us believe that **significant amounts of important information will be shielded from public scrutiny** as they could be considered “confidential or protected information” (business sensitive, trade secret).

Finance Watch believes that investment protection mechanisms and ISDS will further increase the prevalence of private interests at the expense of public interests in financial services regulation, and therefore opposes their introduction in TTIP, regardless of the improvements on transparency.

### **Question 7: Multiple claims and relationship to domestic courts**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

As far as multiple claims and relationship to domestic courts are concerned, we wonder why investors and corporations would need to be granted the possibility to pursue litigation both in domestic courts and arbitration courts. An investor should use the public judicial system in place for any claim, just as any other natural or legal person.

### **Question 8: Arbitrator ethics, conduct and qualifications**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

Arbitrators in private arbitration courts lack the democratic legitimacy of public judicial systems. No rules of conduct, qualification requirements or codes of ethics will alter this fact. An investor should use the public judicial system in place for any claim.

### **Question 9: Reducing the risk of frivolous and unfounded cases**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

As far as the risks of frivolous and unfounded cases are concerned, we would argue that any claim from an investor related to the potential impact of a financial regulation that has been adopted through a democratic regulatory process should be deemed unfounded or illegitimate.

#### **Question 10: Allowing claims to proceed (filter)**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

#### **Question 11: Guidance by the Parties (the EU and the US) on the interpretation of the agreement**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

#### **Question 12: Appellate Mechanism and consistency of rulings**

Finance Watch believes that the introduction of investment protection mechanisms and ISDS into TTIP will further increase the prevalence of private interests at the expense of public interests in financial services regulation and therefore opposes their introduction into the TTIP entirely, regardless of their modalities.

As far as an appellate mechanism is concern, we would argue that, even though it can be considered as a sensible approach, it would also provide investors with the possibility to re-introduce a claim against the first decision of an arbitration court, further delaying important policy measures, increasing legal uncertainty and the risk of regulatory chill.