BEFORE THE INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES UNDER THE RULES GOVERNING THE ADDITIONAL FACILITY FOR THE ADMINISTRATION OF PROCEEDINGS AND UNDER THE NORTH AMERICAN FREE TRADE AGREEMENT

Fireman's Fund Insurance Company
Claimant
v.

The United Mexican States
Respondent

ICSID Case No. ARB(AF)/02/01

FIRST SUBMISSION OF CANADA

PURSUANT TO ARTICLE 1128 OF THE NAFTA

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and International Trade
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I Introduction

1. Pursuant to Article 1128 of the *North American Free Trade Agreement* ("NAFTA"), Canada makes this submission in relation to certain questions of interpretation of the NAFTA raised in connection with the challenge by Respondent United Mexican States ("Mexico") to the jurisdiction of the Tribunal in this proceeding.

2. This submission does not address all interpretative issues that may arise in this proceeding. No inference should be drawn from Canada's silence in relation to interpretative issues not addressed by these submissions.

3. Canada takes no position with respect to issues of fact and the application of these submissions to the facts of this particular case, nor does Canada take a position in relation to the reasonableness of any prudential measure adopted by Mexico relevant to these proceedings.

4. During the hearing on the Preliminary Question on Jurisdiction held at the International Centre for Settlement of Investment Disputes ("ICSID") in Washington on February 6 and 7, 2003, the Tribunal posed several questions to the disputing parties. Where Canada has addressed those questions, it is noted in an accompanying footnote.

II Chapter Fourteen of the NAFTA: A Separate Regime for Financial Services

5. Canada submits that Chapter Fourteen of the NAFTA establishes a separate or special regime for financial services.

6. The financial services sector is unique because of its importance and role in the economy.[1] First, since most transactions in a market economy rely in some way on the financial system, the financial services sector plays an important role in underpinning economic growth. This fundamental role distinguishes the financial sector from most other services sectors.

7. Second, the failure of a financial institution can pose profound risks to a country's financial system, impose large costs upon both private economic actors and governments and lead to major economic crises. History has shown that when a country's financial system experiences difficulties, the very real economic disruptions that ensue often lead to significant costs for governments. Widespread failure in the financial sector can also undermine the ability of other economic sectors to make needed investments and undertake commercial operations.

8. Therefore, efficient and effective regulation and supervision are key to financial services markets. They promote the integrity and soundness of financial institutions and of the financial system as a whole, as well as foster investor and consumer trust and confidence. The regulatory framework for the financial services sector is of a breadth, nature and complexity that is significantly different than that for other sectors of the economy.

9. In recognition of the uniqueness and importance of the financial services sector, the NAFTA Parties negotiated a set of rules and disciplines specific to that sector. These rules and disciplines are found in Chapter Fourteen. They address such issues as self-regulatory organizations (e.g., stock exchanges), establishment of financial institutions, cross-border trade in financial services, non-discriminatory treatment, reservations and liberalization commitments specific to the financial sector, measures taken for prudential reasons, and special rules with respect to dispute settlement. All of these provisions have been tailored to the specific

[1] During the hearing on the Preliminary Question on Jurisdiction, the Tribunal posed several questions to the parties. The first question was as follows: "What were the reasons why a special Chapter Fourteen devoted to "financial services" was included in NAFTA? In connection with this question, you may look in particular to Article 31 and possibly Article 32 of the Vienna Convention referred to by both parties."

nature of the financial services sector. They represent the balance of rights and obligations negotiated by the NAFTA Parties to govern trade in financial services.

10. The intention of the NAFTA Parties to create a separate regime to govern measures relating to financial services within the NAFTA is clearly expressed in the provisions governing the scope and coverage of various Chapters.

11. The scope and coverage of Chapter Fourteen is set out in Article 1401(1), which provides:

> This Chapter applies to measures adopted or maintained by a Party relating to:
>
> (a) financial institutions of another Party;
>
> (b) investors of another Party, and investments of such investors, in financial institutions in the Party's territory; and
>
> (c) cross-border trade in financial services.

12. Thus, Chapter Fourteen applies to measures related to both investment and cross-border trade in financial services. Chapter Eleven (Investment), applicable generally to investment, does not apply to measures covered by Chapter Fourteen. Article 1103(3) reads:

> This Chapter does not apply to measures adopted or maintained by a Party to the extent that they are covered by Chapter Fourteen (Financial Services).

13. Furthermore, Chapter Twelve (Cross-border Trade in Services), applicable generally to cross-border trade in services, does not apply to "financial services, as defined in Chapter Fourteen (Financial Services)": Article 1201(2).

14. The only provisions of the general regime for investment and cross-border trade in services applicable in the financial services sector are those expressly incorporated by reference into Chapter Fourteen through Article 1401(2), which provides:

> Articles 1109 through 1111, 1113, 1114 and 1211 are hereby incorporated into and made a part of this Chapter. Articles 1115 through 1138 are hereby incorporated into and made a part of this Chapter solely for breaches by a Party of Articles 1109 through 1111, 1113 and 1114, as incorporated into this Chapter.

15. The incorporated provisions are: Articles 1109 (Transfers), 1110 (Expropriation and Compensation), 1111 (Special Formalities and Information Requirements), 1113 (Denial of Benefits), 1114 (Environmental Measures) and 1211 (Denial of Benefits to service provider).

16. As a general rule, disputes arising under Chapter Fourteen are subject to the general State-to-State dispute settlement provisions of Chapter Twenty, as modified by Article 1414. The NAFTA Parties incorporated into Chapter Fourteen the investor-state dispute settlement provisions of Section B of Chapter Eleven (Articles 1116 through 1138) solely for breaches of Articles 1109 through 1111, 1113 and 1114, as incorporated into Chapter Fourteen by Article 1401(2).

17. Under Chapter Fourteen, the NAFTA Parties determined the balance of rights and obligations for financial services, including the applicable level of protection for investors. In this regard, Canada submits that a comparison of the protection afforded to investors under Chapters Eleven and Fourteen is irrelevant.[2] As mandated by Article 1131(1), the issues in dispute are to be decided in accordance with the express provisions of the NAFTA.[3]

III Definition of Financial Institution

18. Given that Chapters Fourteen and Eleven are mutually exclusive, one must determine which Chapter applies in respect of a particular measure. In this case, a central issue is what constitutes a "financial institution" for the purposes of Article 1416. While Canada does not take a position in relation to the interpretation and application of the law of Mexico with respect to the definition

[2] The ninth question posed by the Tribunals is as follows: "Is it correct to say that if Chapter Fourteen and not Chapter Eleven applies, that investor protection is in some way impaired?"
[3] Article 1131(1) reads: A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.

of "financial institution," Canada submits the following in relation to the interpretation of "financial institution" as set out in Article 1416.

19. Article 1416 defines "financial institution" for the purposes of Chapter Fourteen as follows:

> **financial institution** means any financial intermediary or other enterprise that is authorized to do business and regulated or supervised as a financial institution under the law of the Party in whose territory it is located;

20. Canada submits that provisions that define the scope of Chapter Fourteen, such as the definition of financial institution, should be interpreted in light of the object and purpose of the NAFTA Parties to establish a separate regime for financial services. To interpret such provisions otherwise would defeat the intention of the NAFTA Parties.

(i) The NAFTA Parties Decide What Constitutes A Financial Institution

21. It is clear from the definition in Article 1416 that what constitutes a financial institution for the purposes of Chapter Fourteen is to be determined by reference "to the law of the Party in whose territory it is located." It is for the NAFTA Parties, through their respective regulatory and supervisory frameworks, to define the types of entities, and hence the scope of activities, that fall within Chapter Fourteen. This self-definition provides each NAFTA Party with the flexibility to adopt a regulatory framework that reflects its own particular circumstances, policy objectives and priorities. It permits differences in the manner in which regulatory oversight is exercised by each NAFTA Party, both in terms of the nature and extent of regulation. It also recognizes that the nature of regulation and supervision is not carved in stone, but may change to adapt to new circumstances.

(ii) The Term "Financial Institution" Is Used Generically in the NAFTA

22. The term "financial institution" as used in Article 1416 does not necessarily correspond to, or is not necessarily synonymous with, the term "financial

institution" as used in the respective domestic laws of the NAFTA Parties. The designation of "financial institution" in domestic law may be narrower or wider than the definition of "financial institution" in Article 1416. The determining factor is not the designation in domestic law *per se*, but the fact that it is regulated or *supervised as a financial institution.*

(iii) **"Financial Institution" Is More Than A Financial Intermediary**

23. It is clear that not just any "financial intermediary or other enterprise" will be considered a financial institution for the purposes of Chapter Fourteen. The "financial intermediary or other enterprise" must be "authorized to do business and regulated or supervised as a financial institution" by the Party in whose territory the entity is located.

24. However, it is equally clear that a financial institution for the purposes of Chapter Fourteen is not limited only to financial intermediaries, such as those entities providing retail financial services (e.g., operating banks and insurance companies). The definition specifically contemplates that an enterprise[4] other than a financial intermediary may be considered a financial institution by the Party in question, provided that it is so authorized, regulated and supervised.

(iv) **A Holding Company May Be A "Financial Institution"**

25. Canada submits that the NAFTA contemplates that Chapter Fourteen may apply to holding companies in the financial sector. For instance, Article 1403(2), where the NAFTA Parties recognize the principle that foreign investors should be permitted to provide a range of financial services through separate financial institutions as may be required by the host Party, contemplates the possibility of various legal structures for the provision of a range of financial services, one of which could be the holding company structure; however, the form or degree of the

[4] *The term enterprise is broadly defined in Article 201(1) to mean "any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association;"*

host Party's regulation or supervision is a matter left to the domestic law of the host Party.[5]

IV Conclusion

26. In conclusion, Canada submits that the determination of whether an entity is "authorized to do business and regulated or supervised as a financial institution" for the purposes of Chapter Fourteen should reflect the fact that it is for the NAFTA Parties, through their respective regulatory and supervisory frameworks, to define the types of entities, and hence the scope of activities, that fall within Chapter Fourteen.

All of which is respectfully submitted,

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[5] Article 1403(2) provides in part: "The Parties also recognize the principle that an investor of another Party should be permitted to participate widely in a Party's market through the ability of such investor to:
(a) provide in that Party's territory a range of financial services through separate financial institutions as may be required by that Party;..."