THE EXTRATERRITORIAL EFFECTS OF THE VOLCKER RULE

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Abstract

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly referred to as the "Volcker Rule", essentially prohibits "banking entities" from engaging in "proprietary trading" and from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or a private equity fund. The rule has been controversial not only because of its substantive content but also due to its extraterritorial reach, which has a significant impact on foreign banking entities that have U.S. affiliates. The Volcker Rule's extraterritoriality lies within the broad definition of the term "banking entity", which includes not only insured depository institutions and U.S. bank holding companies, but also non-U.S. banks which have a U.S. branch or agency and any affiliate of the foregoing on a world-wide basis, whether or not they are organized or located in the United States.

The application of U.S. regulations to entities operating abroad merely because the entities happen to have a U.S. branch is contradictory to the principles of international law. The principles of international law are based on the idea of the sovereignty of nations and territorial application of the law. Yet, in light of the context in which the Volcker Rule was enacted—a crisis which required immediate global regulation of proprietary trading—it was probably the most efficient measure at a moment where other foreign regulators were moving slower and did not show any specific intention to regulate the matter. However, in the quest towards efficiency—and in consideration of the potential for inconsistent regulation among different countries—financial regulators around the world should work towards a uniform and transparent approach that would, ideally, be acceptable by all concerned parties.

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I. Introduction

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Volcker Rule")[1] is often characterized as one of the most controversial provisions of the Act (the "Dodd-Frank Act" or "Act").[2] Essentially, the Volcker Rule prohibits "banking entities"[3] from engaging in "proprietary trading"[4] and from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a "hedge fund or a private equity fund"[5] ("Covered Funds").[6] The controversy surrounding the Volcker Rule pertains not only to the substantive content of the Rule, but also to its extraterritorial reach. The Volcker Rule's extraterritoriality has been actively challenged by foreign commentators.[7] The concept of extraterritoriality refers to the applicability of a sovereign's laws outside of its territory. With regard to the Volcker Rule, this

1. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 619, 124 Stat. 1376, 1620–21 (2010) (codified at 12 U.S.C. § 1851 (2012)) (introducing a new section 13 to the Bank Holding Company Act of 1956); *see also* Bank Holding Company Act of 1956 § 13, 12 U.S.C. § 1841 *et seq.* (2011).

2. *See, e.g.*, Stacy Goto Grant, *International Financial Regulation Through G20: The Proprietary Trading Case Study*, 45 GEO. J. INT'L. L. 1217, 1248 (2014).

3. The term "banking entity" is defined in section 1851(h)(1) as follows:

> any insured depository institution (as defined in section 1813 of [Title 12], any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of any such entity.

12 U.S.C. § 1851(h)(1) (2012).

4. The concept of "proprietary trading" is defined in § 1851(h)(4) as follows:

> engaging as a principal for the trading account of the banking entity or nonbank financial company supervised by the Board [of Governors of the Federal Reserve System] in any transaction to purchase or sell . . . any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule . . . determine.

12 U.S.C. § 1851(h)(4) (2012).

5. The terms "hedge fund" and "private equity fund" are defined in §1851(h)(2) as follows:

> an issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*), but for section 3(c)(1) or 3(c)(7) of that Act [15 U.S.C. 80a-3(c)(1), (7)], or similar funds as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule, as provided in subsection (b)(2), determine.

12 U.S.C. § 1851(h)(2) (2012).

6. *See* 12 U.S.C. § 1851(a)(1) (2012). Under the Final Rule, the concept of Covered Funds includes (i) a fund "that would be an investment company . . . but for Section 3(c)(1) or 3(c)(7) of the [Investment Company Act of 1940];" (ii) a commodity pool the participation units of which are owned by qualified eligible persons (i.e., institutional investors or high-net worth individuals); and (iii) with respect to only U.S. banking entities, a non-U.S. private fund "organized and established outside the United States and the ownership interests of which are offered or sold solely outside the United States." *See* SEC, Final Rule: Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Fund, SEC Release No. BHCA-1, 987–88 (2013), *available at* https://www.sec.gov/rules/final/2013/bhca-1.pdf [hereinafter SEC Release No. BHCA-1].

7. Generally, commenters expressed concerns "that proprietary trading restrictions will have detrimental impacts on the economy such as: reduction in efficiency of markets, economic growth, and in employment due to a loss in liquidity." *See* SEC Release No. BHCA-1, *supra* note 6, at 10.

refers to the applicability of the Rule outside the territory of the United States. The initial drafters of the Volcker Rule envisioned a broad extraterritorial application of the Rule with a limited scope of exemptions available to foreign entities.[8] In the process of the rulemaking, the extraterritorial reach of the Rule became somewhat more limited, to the extent that, under the final agency rules implementing the Volcker Rule (the "Final Rule"),[9] foreign banks are allowed to benefit from some of the exceptions under less stringent conditions (see Section III.A.1.). However, the Volcker Rule remains a regulation with clear extraterritorial applicability (see Section II.B. and Section III.A.1.).

This Article comments on the evolution of the extraterritorial effects of the Volcker Rule, beginning with its initial conception and following with a discussion on the principle of extraterritoriality as adopted in the Final Rule. Part II discusses the background behind the Volcker Rule and to what the Rule applies. Part III will examine the legitimacy of the Final Rule's extraterritorial application. Further, Part III will address the efficiency of the Volcker Rule's ability to meet the regulators' objective of global financial stability. Part IV will examine potential alternatives for achieving the goals via other regulatory solutions. This Article proposes that these alternatives to the Volcker Rule would be internationally recognized and implemented with less controversy. Part V will conclude.

In light of the context in which the Volcker Rule was enacted—a crisis which required immediate global regulation of proprietary trading—it was probably the most efficient measure at a moment where other foreign regulators were moving slower and did not show any specific intention to regulate the matter. However, in the quest towards efficiency, and in consideration of the potential for inconsistent regulation among different countries, financial regulators around the world should work towards a uniform and transparent approach that would, ideally, be acceptable by all concerned parties. The need for a consistent approach on a global level has been recognized both by academics specializing in the field of international financial regulation and by the financial regulation industry.[10] Such a consistent approach will avoid criticism such as the one provoked by the Volcker Rule—the extraterritorial reach of certain U.S. national reforms may result in burdensome overlap of regimes and be inconsistent with longstanding principles of deference to the Home country supervisor.[11]

8. For instance, with respect to the exception available to foreign banks that trade "solely outside of the United States", the Proposed Rule listed four conditions for a transaction to be considered as having occurred solely outside of the United States. Two of the conditions were (1) "[n]o party to the transaction is a resident of the United States", and (2) "[t]he transaction is executed wholly outside of the United States." *See* SEC, Notice of Proposed Rulemaking, SEC Release No. 34-65545, 136–38 (2011), *available at* https://www.sec.gov/rules/proposed/2011/34-65545.pdf [hereinafter SEC Release No. 34-65545]. These conditions eliminated the possibility for a foreign bank to use the exception if it transacted with U.S. counterparties or if the transaction took place on a U.S. exchange.

9. *See generally* SEC Release No. BHCA-1, *supra* note 6. The drafters of the Final Rule are the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (the "OCC"), the Federal Deposit Insurance Corporation (the "FDIC"), the Securities and Exchange Commission (the "SEC") and the Commodity Futures Trading Commission (the "CFTC"), collectively the "Competent Regulators". *See id.* at i.

10. *See i.e.*, GEORGES UGEUX, INTERNATIONAL FINANCIAL REGULATION: THE QUEST FOR FINANCIAL STABILITY xxvii (2014).

11. For a general comment on the effects of the extraterritorial financial regulation and the concept of "substitute compliance" (deference to the Home country supervisor), see generally John C. Coffee Jr., *Symposium on Extraterritoriality: Essay: Extraterritorial Financial Regulation: Why E.T. Can't Come Home*, 99 CORNELL L. REV. 1259 (2014).

II. Background

A. Context of the Enactment of the Volcker Rule

Historically, the securities activities of commercial banks have been the target of the Glass-Steagall Act of 1933 ("Glass-Steagall").[12] Glass-Steagall was a reaction to another major crisis, the banking crisis of 1929–33, commonly referred to as the "Great Depression". Glass-Steagall's main contribution was the separation of commercial banking and investment banking.[13] However, by the time the financial crisis of 2008 hit the global economy, financial institutions were operating under a more liberal regime. The so called "Glass-Steagall Wall", existing between commercial banking and investment banking, was officially eliminated in 1999 by the Gramm-Leach-Bliley Act.[14] As a result, banks could affiliate through specially qualified bank holding companies, known as "financial holding companies", with companies engaged in a full range of financial activities.[15] Thus, banking institutions were once again permitted to engage, through their affiliates, in speculative activities.

Moreover, prior to the enactment of the Dodd-Frank Act, commercial banks were participating in the financial marketplace by engaging in another speculative activity—proprietary trading. Banks were buying, holding, and selling securities for their own account "in the expectation of profits from changes in market prices."[16] Like other investors seeking high returns on supposedly safe products, banks were purchasing mortgage-backed securities. It is now a well-known fact that large banks suffered spectacular trading losses during the financial crisis of 2008.[17] Once again, the need for controlling the risk undertaken by commercial banks became apparent. This time, the relevant legislation (the Volcker Rule) targeted different activities (proprietary trading and relationships with certain funds), but its rationale is reminiscent of previous legislative concerns: separating the commercial banking from risky speculative activities.

In his comment letter addressing the initial draft of regulation implementing the Dodd-Frank Act (the "Proposed Rule"), Paul Volcker re-emphasizes the logic behind the Act and comments on the necessity of understanding the philosophy and purpose of the implementing regulations. He highlights the basic public policy set out by the Act as follows: "the continuing explicit and implicit support by the Federal government of commercial banking organizations can be justified only to the extent those institutions provide essential financial services."[18] In Paul Volcker's opinion, proprietary trading "does not justify the taxpayer subsidy implicit in routine access to Federal Reserve credit, deposit insurance and emergency support."[19] More importantly,

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12. *See generally* Glass-Steagall Banking Act of 1933, Pub. L. No. 114-38, 48 Stat. 162 (1933).
13. *See generally* RICHARD CARNELL, JONATHAN MACEY, & GEOFFREY MILLER, THE LAW OF BANKING AND FINANCIAL INSTITUTIONS 17–18 (4th ed. 2009) (discussing the historical context of Glass-Steagall's enactment).
14. The Gramm-Leach-Bililey Act is also known as the Financial Services Modernization Act of 1999. *See generally* Financial Services Modernization Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (1999).
15. *See* CARNELL, MACEY, & MILLER, *supra* note 13, at 27.
16. *See* Paul A. Volcker, Commentary on the Restrictions on Proprietary Trading by Insured Depository Institutions 2 (Feb. 13, 2012), *available at* https://www.sec.gov/comments/s7-41-11/s74111-182.pdf.
17. *See id.*
18. *Id.* at 1.
19. *Id.*

Paul Volcker blames proprietary trading for contributing to the financial crisis of 2008 by jeopardizing the stability of important banks who had suffered losses as a result of such speculative activities.[20]

B. Scope of the Volcker Rule

The Volcker Rule generally prohibits banking entities from engaging in proprietary trading and from investing in and sponsoring certain hedge funds and private equity funds (referred to in Part I as Covered Funds) subject to a number of exceptions.[21] Some of the exceptions include underwriting and market-making related activities, trading by a non-U.S. bank in the sovereign obligations of its Home country, trading on behalf of customers, and trading by a non-U.S. banking entity that is conducted "solely outside of the United States" (the "SOTUS Exception").[22]

According to the U.S. Supreme Court, "[i]t is a 'longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'"[23] Thus, American law recognizes the principle that in the absence of clear Congressional intent to give the legislative act an extraterritorial application, the act is presumed to apply domestically.[24] In the Dodd-Frank Act, a clear Congressional intent exists to address certain regulatory issues as a global concern. The Volcker Rule is an example of Congressional intent. The Volcker Rule's extraterritoriality lies in the broad definition of the term "banking entity", which "includes . . . insured depository institutions[25], U.S. bank holding companies, non-U.S. banks with a U.S. branch or agency, and any affiliates of the foregoing around the globe, whether or not they are organized or located in the United States."[26] By purposefully including a broad definition of banking entities to cover non-U.S. banks with a U.S. branch or agency and any affiliate of such entity, the Rule clearly demonstrates Congress's intent to reach beyond the borders of the United States.

III. Discussion

A. Volcker Rule's Extraterritorial Application to Non-U.S. Entities

The Volcker Rule grants to international banking organizations headquartered outside of the United States some flexibility to engage in certain activities falling within the scope of available exemptions as discussed herein. However, these institutions are still required to invest efforts into the implementation of organizational arrangements, such as specific compliance

20. *Id.* at 20.
21. *See generally* 12 U.S.C. § 1851 (2012); *see* SEC Release No. BHCA-1, *supra* note 6, at 986 *et seq.*
22. *See* 12 U.S.C. § 1851(d)(1).
23. *See* Morrison v. Nat'l Austrl. Bank Ltd., 561 U.S. 247, 255 (2010) (citing EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991)).
24. *See Morrison*, 561 U.S. at 255.
25. 12 U.S.C. § 1813(c)(2) (2010).
26. Robin Maxwell & Jacques Schillaci, *The Final Volcker Rule and Its Extraterritorial Consequences for Non-U.S. Banks*, LINKLATERS 3 (Dec. 20, 2013), *available at* http://www.linklaters.com/Insights/US-Publications/Pages/Final-Volcker-Rule-Extraterritorial-Consequences-Non-US-Banks.aspx.

programs, designed to make sure that the conditions of the applicable exemption are met and the entity is not engaged in a prohibited activity.

The Final Rule and its subsequent interpretative guidance set forth the precise scope of the Volcker Rule's extraterritorial application. To appreciate the importance of the extraterritoriality of the Volcker Rule, it is necessary to observe the content of the Final Rule in comparison with the initial proposal for regulation (the "Proposed Rule").[27] The Proposed Rule was released for comment more than two years prior to the adoption of the Final Rule and was the subject of numerous critiques that were mainly directed against its expansive extraterritorial reach.[28] With an apparent intent to promote competitive parity between U.S. and non-U.S. banking organizations, the Proposed Rule introduced an expansive approach to extraterritoriality and a restrictive reading of the statutory exemptions for non-U.S. trading and funds activities.

1. The Proprietary Trading Ban and Available Exemptions

a. The "SOTUS" Exception

The statutory text defines "permitted activity" as any proprietary trading that occurs "solely outside of the United States" (commonly referred to as the "SOTUS Exception"), provided that the entity which conducts the trading "is not directly or indirectly controlled by a [U.S.] banking entity."[29] The Proposed Rule had adopted a restrictive approach towards this exception, taking the position that the exemption should not apply if the trading involved a U.S. counterparty[30] or occurred on a U.S. exchange or trading facility.[31] The Final Rule is less restrictive to the extent that it permits a foreign bank to benefit from the SOTUS Exception even when it uses U.S. infrastructure and/or transacts with certain U.S. entities so long as the transaction took place "solely outside of the United States".[32] More specifically, a foreign banking entity will not be subject to the proprietary trading ban if it satisfies the following conditions: "(i) the [non-U.S.] banking entity engaging as principle in the purchase or sale (including any personnel . . . that arrange, negotiate or execute such purchase or sale) is not located in the United States . . .; (ii) the decision to purchase or sell" is made outside of the United States; "(iii) the purchase or sale . . . is not accounted for as principal directly or on a consolidated basis by any branch or affiliate that is located in . . . or organized under the laws of the United States . . . ; (iv) no financing . . . is provided, directly or indirectly, by any branch or affiliate located in . . . or organized under the laws of the United States . . . ; and (v) the purchase or sale is not conducted with or through any U.S. entity," subject to several exceptions.[33] These exceptions make

27. *See generally* SEC Release No. 34-65545, *supra* note 8.

28. *See* SEC Release No. BHCA-1, *supra* note 6, at 440–52.

29. 12 U.S.C. § 1851(d)(1)(H) (2012).

30. SEC Release No. 34-65545, *supra* note 8, at 136. The Proposed Rule required that "[n]o party to the purchase or sale [be] a resident of the United States". *Id.* The term "resident of the United States" was defined in a broader manner than in Regulation S, but in the Final Rule, the Competent Regulators decided to define the term via reference to Regulation S. SEC Release No. BHCA-1, *supra* note 6, at 1021.

31. Proposed Rule §_.6(d)(3)(iv) provides that "[t]he purchase or sale [be] executed wholly outside of the United States." *See* SEC Release No. 34-65545, *supra* note 8, at 410.

32. *See* SEC Release No. BHCA-1, *supra* note 6, at 453 *et seq.*

33. *Id.* at 454–55.

possible transactions with the following U.S. entities: (i) "the foreign operations of a U.S. entity", provided "no personnel . . . located in the United States are involved in the arrangement, negotiation or execution of such purchase or sale"; (ii) "an unaffiliated market intermediary acting as principal, provided the [transaction] is promptly cleared and settled through a clearing agency or derivatives clearing organization"; and (iii) "an unaffiliated market intermediary" acting as agent, "provided [the transaction] is conducted anonymously . . . on an exchange or similar trading facility and promptly cleared and settled through a clearing agency or derivatives clearing organization."[34]

As the Competent Regulators explain, the purpose of the conditions is to "ensure[s] that the risk, decision-making, arrangement, negotiation, execution and financing of the [trading] activity resides outside the United States and limits the risk to the U.S. financial system from trades by foreign banking entities with or through U.S. entities."[35] At the same time, the drafters of the Final Rule took into consideration some of the risks outlined by the commenters of the Proposed Rule. For instance, the Final Rule addresses some of the concerns with respect to the competitiveness of the U.S. trading platforms, which would suffer if foreign banks were completely forbidden from using them for their proprietary trading activity, since there would have been a considerable "relocation of these activities that supports the financial stability and efficiency of U.S. markets."[36] Moreover, the Final Rule allows foreign banks to transact with some U.S. entities under specific circumstances, which not only allows foreign banks more flexibility under the exemption but also improves the competitiveness of the U.S. entities permitted to engage in the transactions.[37] Despite the relatively enlarged scope of the SOTUS Exception, as Professor J. Coffee, Jr. observes, "the Volcker Rule effectively does apply extraterritorially because at a minimum it requires banks with U.S. branches to undertake significant compliance obligations to assure that their trading stays well outside the United States."[38]

b. Other Available Exceptions

Further, other exceptions are also available to foreign banks such as the general (i.e., applicable to all entities) exceptions for market-making and underwriting.[39] However, these exceptions require more burdensome compliance programs due to the granular focus on the activities and position limits imposed at the "trading desk" level of organization ("defined as the smallest discrete trading unit of the bank").[40]

Thus, even though a foreign banking entity with a presence in the United States may be able to operate under one of the available exemptions, it must still consider the Volcker Rule's ban on proprietary trading. The foreign banking entity may not be subject to the ban itself, but since it is subject to the Volcker Rule, it

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34. *See id.* at 455.
35. *Id.* at 455–56.
36. *Id.* at 449.
37. *See id.* at 455.
38. *See* Coffee, Jr., *supra* note 11, at 1289.
39. 12 U.S.C. 1851 (d)(B).
40. Maxwell & Schillaci, *supra* note 26, at 5; *see* SEC Release No. BHCA-1, *supra* note 6, at 966–67.

needs to take the necessary measures to ensure compliance with the specific conditions of the exemptions.

2. The Covered Funds Ban and Available Exemptions

A foreign banking entity with a branch or subsidiary in the United States has to make sure it does not cross the limits of the permissible investing in and/or sponsoring of the so-called "Covered Funds".[41] However, it benefits from considerable flexibility, in comparison with its U.S. counterparties, since it is permitted, for instance, to invest in non-U.S. private funds "organized or established outside of the United States and the ownership interests of which are offered or sold solely outside of the United States" ("Foreign Private Funds").[42] A foreign banking entity is permitted to have such investment activity even though it does not meet all requirements of the SOTUS Exception. At the same time, a U.S. banking entity is not able to invest in the same funds. Foreign Private Funds are exempt from the definition of Covered Funds only with respect to foreign banks.[43] Alternatively, foreign banks can benefit from a specific SOTUS Exception for investment activity in Covered Funds ("Covered Funds SOTUS Exception").[44] The impact of this exception is relatively limited considering the availability of the Foreign Private Funds rule, but can still have some utility "for investments (i) in U.S. organized funds and (ii) hedge funds or other vehicles engaged in proprietary trading activities."[45] The Covered Funds SOTUS Exception has similar conditions for situs of the activity "solely outside of the United States" as the proprietary trading SOTUS Exception, in addition to the requirement that the offering of interests in the Covered Fund must not "target" residents of the United States.[46]

B. The Volcker Rule's Extraterritorial Application to U.S. Entities

The extraterritorial application of the Volcker Rule to the foreign operations of U.S. entities is an issue that was subject to vigorous discussion after the publication of the Proposed Rule. However, commentators have made less progress towards a relaxation of the rule.

The Competent Regulators considered the effect of the Volcker Rule's restrictions on the competitiveness of a U.S. banking entity outside of the United States.[47] They recognized the fact that the possibility to effectively compete "often improves the potential for these [entities] to succeed and be profitable, and thereby, often improves the safety and soundness of the entity and financial

41. Under the Final Rule, the concept of Covered Funds includes (i) a fund that would be an investment company but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, (ii) a commodity pool the participation units of which are owned by qualified eligible persons (institutional investors; high-net worth individuals), and (iii) with respect to U.S. banking entities only, a non-U.S. private fund "organized and established outside of the United States and the ownership interest of which are offered or sold outside of the United States." *See* Release No. BHCA-1, *supra* note 6, at 987–97.

42. *See id.* at 521–22, 988.

43. *See id.*

44. *See id.* at 1019–20.

45. *See* Maxwell & Schillaci, *supra* note 26, at 10.

46. *See* SEC Release No. BHCA-1, *supra* note 6, at 1019 *et seq.*

47. *See id.* at 456.

stability in the United States."[48] However, the Competent Regulators refused to go against the Congressional intent "to generally prohibit U.S. banking entities (including their subsidiaries and branches) from engaging in proprietary trading."[49] Thus, they refused to allow U.S. banks to conduct, through their subsidiaries and branches located outside of the Unites States, the activity which they were prohibited from conducting through their U.S. operations.[50] Such authorization would have subjected the U.S. banking entities and the U.S. economy to the very risk which Congress attempted to avoid. Consequently, the Final Rule confirms that the SOTUS Exception is available only if the banking entity is not organized under, or controlled by an entity organized under, the laws of the United States.[51]

Similarly, as mentioned above, a U.S. banking entity is given less freedom to invest in or sponsor Covered Funds. It does not benefit from the exception available for foreign banking entities to invest in foreign funds.[52] Even if the fund is foreign and the investment takes place outside of the United States, it is still considered a "Covered Fund" with respect to U.S. banking entities.[53]

This extraterritorial reach with respect to U.S. entities operating abroad has been explained with the Volcker Rule's objective to ensure the "safety and soundness" of U.S. entities and the stability of the U.S. economic system.[54] A closer look at the Volcker Rule's rationale can shed light upon the reason for such broad extraterritorial application.

C. Rationale and Legitimacy of the Volcker Rule's Extraterritorial Reach

The Volcker Rule's underlying rationale, as expressed by the former Federal Reserve chairman Paul Volcker, is that the scope of any implicit federal guarantee shall be limited to a relatively small number of important banking institutions and to core banking activities, rather than extend across the spectrum of financial intermediaries and risky activities.[55] As to the Final Rule, its drafters are clearly preoccupied with concerns regarding the "safety and soundness" of banking institutions and the financial stability of United States as a whole.[56] This concern is, in fact, a fundamental consideration that Congress used to guide the Competent Regulators in their drafting of the Final Rule.[57]

The safety and soundness of banking institutions and the financial stability are universal concerns that have been addressed in other parts of the world. However, the approaches used by foreign regulators were not necessarily identical to the approach used by the Volcker Rule. For instance, the European Union has

48. *See id.*
49. *See id.*
50. *See id.* at 457.
51. *See id.*
52. *See id.* at 522, 988.
53. *See id.* at 522, 988.
54. *See id.* at 465.
55. *See* VIRAL V. ACHARYQ, REGULATING WALL STREET: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE 198 (Wiley 2011).
56. *See* SEC Release No. BHCA-1, *supra* note 6, at 465.
57. *See* 12 U.S.C. § 1851(d)(J) (2012).

also considered separating commercial banking from more speculative activities.[58] However, Europe has been traditionally attached to the concept of universal banking and therefore has been less enthusiastic about breaking from this model.[59] Moreover, Europe (but also other regions of the world such as some Asian countries) has been particularly sensitive to the extraterritorial reach of American regulations; in particular, the Volcker Rule. The extensive extraterritorial approach of the Proposed Rule met clear opposition. The European Commissioner for Internal Market and Services, Michel Barnier, participated in actions against the Proposed Rule, stating that it was not "acceptable that U.S. rules have such a wide effect on other nations."[60]

The domination of the United States in the global regulatory process and the extraterritorial reach of some of the U.S. regulations have even led commentators to ask whether the global financial regulation will not become "Lex America".[61] It is true that applying U.S. regulations to entities operating abroad merely because they happen to have a U.S. branch is in contradiction with the principles of international private law, which are based upon the idea of the sovereignty of nations and territorial application of the law. Under such international private law approach, a European country will require a local branch of a U.S. bank to respect its rules but will not impose regulations to the U.S. bank regarding the U.S. activities simply because the U.S. bank has a local European branch.

Although such an extraterritorial application of U.S. regulation may be controversial, the United States was the first country to propose a regulatory solution addressing the causes of the global financial crisis.[62] Considering the consequences of the crisis, no one can deny that adequate regulation was indispensable. At the time the effects of the Volcker Rule were discussed before the Senate and the House of Representatives, the United States was the only nation to have taken any action to fundamentally reform the financial sector, and more particularly, to separate commercial banking from riskier activities.[63] As Lael Brainard, former Under Secretary of the Treasury for International Affairs,

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58. This was the subject matter of the Liikanen Report, issued by a high-level expert group on structural banking reforms established by Commissioner Michel Barnier in February 2012; the group was chaired by Erkki Liikanen. *See generally* ERKKI LIIKANEN ET AL., HIGH-LEVEL EXPERT GROUP ON REFORMING THE STRUCTURE OF THE EU BANKING SECTOR (Brussels Oct. 2, 2012), *available at* http://ec.europa.eu/internal_market/bank/docs/high-level_expert_ group/report_en.pdf; *see also* EUROPEAN COMMISSION, PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON STRUCTURAL MEASURES IMPROVING THE RESILIENCE OF EU CREDIT INSTITUTIONS (Jan. 29, 2014), *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:520 14PC0043&from=EN (under review pursuant to EU legislative procedure).

59. For a discussion on the universal banking model and the different approaches in terms of reforms, *see* UGEUX, *supra* note 10, at 89 *et seq.*

60. *See* Yalman Onaran, *Bank Lobby Widened Volcker Rule, Inciting Foreign Outrage*, BLOOMBERG (Feb. 23, 2012), http://www.bloomberg.com/news/articles/2012-02-23/banks-lobbied-to-widen-volcker-rule-before-inciting-foreigners-against-law.

61. UGEUX, *supra* note 10, at xx.

62. As a comparison, the U.K. Vickers' Report dates from 2011 and the Liikanen Report dates from 2012. *See generally* LIIKANEN ET AL., *supra* note 58; *see also* EUROPEAN COMMISSION, *supra* note 58; *see also* INDEP. COMM'N ON BANKING, INTERIM REPORT CONSULTATION ON REFORM OPTIONS (Apr. 2011), *available at* http://s3-eu-west-1.amazonaws.com/htcdn/Interim-Report-110411.pdf.

63. As a comparison, the U.K. Vickers' Report dates from 2011 and the Liikanen Report dates from 2012. *See generally* LIIKANEN ET AL., *supra* note 58; *see also* EUROPEAN COMMISSION, *supra* note 58; *see also* INDEP. COMM'N ON BANKING, INTERIM REPORT CONSULTATION ON REFORM OPTIONS (Apr. 2011), *available at* http://s3-eu-west-1.amazonaws.com/htcdn/Interim-Report-110411.pdf.

stated before the Senate at a Hearing dealing with the international harmonization of the Wall Street reform, "[t]he expectation was that by moving fast with a comprehensive set of reforms, the United States will lead from a position of strength and others will enact reforms consistent with the U.S. one."[64]

Some initiatives did indeed follow the U.S. actions in other parts of the world, such as the U.K.'s Vickers' Report[65] which includes proposals that big banks shall be required to ring-fence[66] certain riskier operations from their consumer businesses. For example, the Liikanen Report on a European Union Level led to the adoption of a proposal for regulation that allows banks to provide hedging services to non-bank clients within a ring-fenced banking entity but requires speculative trading and "any assets or derivative portions incurred in the process of market-making" to be separated in a distinct trading entity.[67] France introduced reforms on a national level, similarly using the ring-fencing concept rather than resorting to a ban on proprietary trading.[68] However, these initiatives demonstrate that, although the different countries are preoccupied with similar concerns, their regulation differs in the means of achieving the common goals. Such divergence inevitably shows that arriving at a uniform solution will prove to be a difficult task. As a practical matter, divergence also results in unjustified burden for financial firms with global operations. Such firms risk becoming subject to overlapping rules, requiring them to monitor their compliance with multiple restrictions.

These initiatives were undertaken a couple of years after the Dodd-Frank Act. In a context of inertia of foreign financial regulators and apparent difficulty to arrive at a common approach, the Volcker Rule can be seen as a justified impulse for a structural reform of the causes having led to the global financial crisis. Moreover, it shall be acknowledged that the Final Rule (as compared to the Proposed Rule) adopts an approach that is less questionable from an international private law perspective, to the extent that, in its view, the United States regulates its own banks, even when they act abroad, but oversees foreign banks when they are acting on the U.S. territory, and thus "rests on a combination of inherent sovereignty and territorialism."[69]

However, no matter how the approach may be justified in the particular circumstances, a financial regulation on any aspect, led by a single country, will continue, as a general matter, to be opposed by other countries. At the same time, a consensus among all implicated parties on the issue of separating commercial banking from speculative activities in particular, and on the issue of global financial regulation in general, seems to be an unachievable task.

64. *International harmonization of Wall Street reform: Orderly Liquidation, Derivatives, and the Volcker Rule: Hearing Before the Comm. on Banking, Hous. & Urban Affairs*, 112th Cong. 39 (Mar. 22, 2012).

65. *See* INDEP. COMM'N ON BANKING, *supra* note 62.

66. *See id.* at 76. For a general discussion on ring-fencing, see Steven L. Schwarcz, *Ring-Fencing*, 87 S. CAL. L. REV. 69 (2013). In this context, ring-fencing means that banks will be required to take deposits through a subsidiary which is a legal entity different from the legal entities that engage in riskier activities such as trading.

67. *See* Grant, *supra* note 2, at 1257.

68. "LOI n° 2013-672 du 26 juillet 2013 de séparation et de régulation des activités bancaires" (French law relating to the separation and regulation of banking activities), *available at* http://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000027754539; *see* Grant, *supra* note 2, at 1258–59 (commenting on the aforementioned regulation).

69. *See* Coffee, Jr., *supra* note 11, at 1290.

The divergent approaches on a single issue, exposed above, are the proof. In such case, is there a solution for finding a consistent and transparent way to regulate the problems of the financial industry that have become intrinsically global?

IV. Towards a Uniform Regulation of Global Financial Concerns

As Chairman Johnson, former chairman of the Senate Banking Committee, stated "[a]mong the many lessons apparent from the recent financial crisis is that the financial system is truly global and that risks and regulations in one country can have significant effects on institutions and markets worldwide."[70] Consequently, the need for global financial regulation has reaffirmed itself with a new force since the financial crisis in 2008. As to the possible solutions, however, there is much less of a consensus among professionals, academics, and commentators. While most agree that soft-law norms issued by various international financial institutions such as the International Monetary Fund (IMF), the World Bank, the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO), and the Financial Stability Board (FSB), are insufficient to efficiently address global concerns due to their non-binding nature,[71] there are divergent views as to the way to achieve such efficient global regulation. One of the solutions, advanced by Professor John Coffee, Jr., is to achieve consistency through "minilateral" negotiation (i.e., negotiation between a small number of nations); for instance, the United States and the European Union, as representative of its Member States, thus avoiding the difficulty of reaching consensus typical for multilateral negotiations.[72] Others see the G20 as a body having the necessary legitimacy of directing the BCBS and FSB to draft "an international accord that will ring-fence retail banking operations from speculative proprietary trading and simultaneously impose higher capital and quantitative limits on non-bank systemically important financial institutions (SIFIs) that choose to engage in proprietary trading."[73] Yet others suggest a multi-pillar approach, including macro-prudential supervisor whose duties would be assigned to a "revamped IMF" and a micro-prudential supervisor, whose role would be assumed by the Bank of International Settlements (BIS).[74] These proposals, among others, are centered on the idea of international cooperation either through (i) an international body with the necessary legitimacy to impose binding norms and supervise firms with cross-border activities; or (ii) negotiations among several leading financially developed countries. Unfortunately, the idea of such international cooperation, although absolutely necessary, may face the problems exposed above: difficulty of reaching consensus, lack of legitimacy of institutions to impose binding norms, and refusal by some countries to be burdened by regulation from other countries or institutions. The United States itself is not necessarily receptive to the imposition of norms by international

70. *International Harmonization of Wall Street Reform: Orderly Liquidation, Derivatives, and the Volcker Rule: Hearing Before the Comm. on Banking, Hous. & Urban Affairs*, 112th Cong. (Mar. 22, 2012) (opening statement of Chairman Johnson).

71. *See, i.e.*, Coffee Jr., *supra* note 11, at 1298.

72. *Id.* at 1265–66.

73. *See* Grant, *supra* note 2, at 1260.

74. *See* EMILIOS AVGOULEAS, GOVERNANCE OF GLOBAL FINANCIAL MARKETS 432–33 (Cambridge Univ. Press 2012).

standard-setting bodies. For instance, in another context, the U.S. Securities and Exchange Commission (SEC) was overtly opposed to IOSCO's "Suitability Requirement with Respect to the Distribution of Complex Financial Products" report, published in January 2013.[75]

To avoid the problem of countries' refusal to cooperate in order to ascertain their sovereignty, one solution is to create another form of international cooperation through voluntary adherence by global financial entities (such as banking conglomerates) to a kind of self-regulatory authority. Such form of public-private partnership, in which banks are members of a self-regulatory authority subject to regulation may avoid the problem of a lack of legitimacy and difficulty in reaching consensus. Of course, such authority cannot exist completely independently. It has to be overseen by a more powerful institution. It could be imagined that the G20 sets its agenda as a general matter and broadly oversees its activity. A serious difficulty will be to incentivize big banks to voluntarily submit themselves to regulation. A possible way to resolve this issue is to make the adherence to the authority a reputational concern such as the banks that join, by signing the charter of cooperation that would be created by the authority, could market themselves as safer institutions.

The creation of such authority, although a challenging task, may become the solution for a transparent, consistent, and efficient regulation of global financial concerns, and will simultaneously avoid the controversy surrounding the extraterritorial effects of national regulation such as the Volcker Rule. Although based on the idea of self-regulation, such authority will need, at least in the initial stage of its creation, the sponsorship of financially developed countries, such as the United States. To achieve such uniform and internationally recognized solution, the United States, as well as other leading economies, should abandon their extraterritorially applicable rules, and rather focus their resources on contributing to a common international arrangement. By sponsoring such an arrangement, the United States, and other strong economies, will be able to maintain their leading position in the global financial market and advance their understanding of efficient financial regulation in a less controversial manner. Although created with the active help of major financial forces, the international arrangement will not be imposed by a single country and neither will it rely on complete consensus among countries. It will be developed through incentivizing global private actors to participate in the quest for the appropriate solution, and thus it could receive broader acceptance.

Finally, it is important to note that financially developed countries, such as the United States, will be able to maintain their dominant positions in this public-private regulatory arrangement, because of the strong positions private actors in such countries hold on the financial market. This could only make this solution all the more viable and politically acceptable while safeguarding the territorial principles of international law.

75. *See* UGEUX, *supra* note 3, at 45 (discussing the SEC's position).

V. Conclusion

The financial crisis of 2008 has reaffirmed the need to monitor global financial regulation and to control the risky activities of major financial institutions, whose operations affect the global economy. Proprietary trading is one such activity and the United States put into place a solution to regulate it both domestically and, in certain aspects, extraterritorially, through the Volcker Rule. However, a regulation imposed globally by one or even several countries would naturally meet the opposition of other sovereigns attached to the idea that they are the ones to determine the laws applicable to their territory. Thus, to avoid the controversy surrounding laws with extraterritorial application, an alternative approach to global regulation should be sought. One possible alternative solution is to incentivize global financial institutions to adhere to a self-regulatory regime, based on collaboration between regulated institutions and regulatory bodies, and sponsorship by major financially developed countries.