THE EXTRATERRITORIAL PROVISIONS OF THE DODD-FRANK ACT PROTECTS U.S. TAXPAYERS FROM WORLDWIDE BAILOUTS

Michael Greenberger*

The significant extraterritorial scope of the derivatives regulation within the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] promises to foster rigorous international standards for financial regulation that will restore transparency and stability to the global derivatives market. At present, that market exceeds $700 trillion notional value, or over ten times the world GDP.[2] Despite opposition from Wall Street to the present extraterritorial application of almost all of Dodd-Frank's derivatives regulation, the plain language of the statute requires implementing that regulation on an appropriate extraterritorial basis in order to protect U.S. taxpayers from bailing out financial institutions engaging in foreign derivatives trading, as was required of those taxpayers after the subprime credit meltdown of 2008.[3]

The unregulated nature of the global derivatives market exposes the world to continued systemic risk, especially in a time of worry about sovereign defaults and the defaults of banks that hold, or have insured through synthetic derivatives, sovereign debt.[4] Defaults of that nature are conceded by almost everyone as having the ability to trigger undercapitalized and non-transparent credit derivatives of the kind that compounded the 2008 subprime fiasco and that led to the U.S. taxpayers' near-$13 trillion bailout of the financial industry.[5] With worldwide economic stability at stake, tough, but appropriate,

---

* Professor, University of Maryland Francis King Carey School of Law; Founder and Director, University of Maryland Center for Health and Homeland Security; former Director, Division of Trading and Markets, United States Commodity Futures Trading Commission. The author would like to thank George Waddington, J.D., University of Maryland Center for Health and Homeland Security, for his contributions to this article. This article was submitted to the UMKC Law Review on June 19, 2012.

[1] Dodd-Frank Wall Street Reform and Consumer Protect Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] Katy Burne, *Complex Financial Bets Rise Ahead of Overhaul*, WALL ST. J., Nov. 16, 2011, at C4.

[3] *See* Bradley Keoun & Craig Torres, *Foreign Banks Tapped Fed's Secret Lifeline Most at Crisis Peak*, BLOOMBERG (Apr. 1, 2011, 12:53 PM), http://www.bloomberg.com/news/2011-04-01/foreign-banks-tapped-fed-s-lifeline-most-as-bernanke-kept-borrowers-secret.html (reporting that foreign banks accounted for at least seventy percent of the $110.7 billion borrowed from the U.S. Federal Reserve's discount window during a record lending week in October 2008).

[4] *See* Abigail Moses, *Greece Auction to Settle $3.2 Billion of Credit-Default Swaps*, BLOOMBERG BUSINESSWEEK, Mar. 18, 2012, http://www.businessweek.com/news/2012-03-18/greece-auction-to-settle-3-dot-2-billion-of-credit-default-swaps ("Greek credit-default swaps are being settled after investors were forced to exchange their bonds at a loss in the biggest ever debt restructuring. The auction ends more than two years of speculation over whether the derivatives are viable for insuring sovereign debt after European policy makers sought to prevent payouts on concern they'd worsen the region's crisis."). Additionally, *Bloomberg* reported that investors wrote off more than $132 billion in Greek debt for "new bonds worth 31.5 percent of their original investment" and that Portugal may also reduce its debt by "imposing losses on private bondholders." *Id.*

[5] *The True Cost of the Bank Bailout*, PBS (Sept. 3, 2010), http://www.pbs.org/wnet/need-to-know/economy/the-true-cost-of-the-bank-bailout/3309/.

extraterritorial regulatory protections for the derivatives markets are needed instantaneously.

This article shows that the extraterritorial reach of Dodd-Frank derivatives rules on capitalization, collateralization, and transparency will restore stability and integrity to the global derivatives market. To this end, the article is divided into five parts. First, the article demonstrates how Dodd-Frank aims to regulate derivatives trading so as to avoid, *inter alia*, the kind of systemic risk that presented itself in the wake of the subprime mortgage meltdown. Second, it establishes that Congress, pursuant to its constitutional authority, intended U.S. financial reforms to apply on an extraterritorial basis so long as the United States has a vested relationship to the derivatives transactions in question. Third, the article discusses the current controversy caused by worldwide "Too Big to Fail" banks and the European Union surrounding the extraterritorial scope of Dodd-Frank-mandated reforms. Fourth, the article defends the extraterritorial application of Dodd-Frank regulations when a derivatives trade either involves a U.S. party or has the potential to substantially threaten the U.S. economy: it demonstrates that Congress has the constitutional authority to direct the extraterritorial application of U.S. derivatives regulations and that such an application aligns with U.S. regulators' standard enforcement practices. Fifth, the article shows that the extraterritorial scope of Dodd-Frank regulation is necessary to protect U.S. taxpayers from the risks posed by the global derivatives market as it affects U.S. interests and that that scope will benefit U.S. banks and the U.S. economy by establishing a more stable derivatives market. For that matter, the extraterritorial application of Dodd-Frank derivatives standards will protect foreign taxpayers from further bailouts of defaulting and the world economy from systemically risky banking institutions.

I. THE DODD-FRANK ACT AIMS TO RESTORE TRANSPARENCY AND STABILITY TO THE DERIVATIVES MARKET

On July 21, 2010, President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) into law. The statute aims "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system."[6] It also aims "to protect the American taxpayer by ending bailouts" and to end the "abusive financial services practices"[7] that led to the 2008 financial crisis.

Dodd-Frank transforms the regulation of what was the over-the-counter (OTC) derivatives market by subjecting most swaps to clearing and exchange trading, including capital, margin and reporting requirements.[8] Title VII of that

---

[6] Dodd-Frank Act at Preamble.
[7] *Id.*
[8] BAIRD WEBEL ET AL., CONG. RESEARCH SERV., R40975, FINANCIAL REGULATORY REFORM AND THE 111TH CONGRESS 12 (2010), *available at* http://fpc.state.gov/documents/organization/141604.pdf ("H.R. 4173 . . . mandate[s] reporting, centralized clearing, and exchange-trading of OTC

statute requires all "swap dealers" (SDs) and "major swap participants" (MSPs) to register with the Commodities Futures Trading Commission (CFTC) and/or Securities and Exchange Commission (SEC)[9] and to disclose any material risks associated with swaps as well as any material incentives or conflicts of interest.[10] Additionally, SDs and MSPs must meet capital requirements and conform to business conduct rules that include prohibitions against fraud and market manipulation.[11] SDs and MSPs must conform to position limits on their commodity swaps trades and report swaps transactions to U.S. regulators.[12]

Additionally, Dodd-Frank imposes clearing and exchange requirements on standardized swap transactions.[13] A clearing facility stands between the buyer and seller of a contract to guarantee each against the failure of the other party.[14] To avoid their own liability, clearing facilities have a strong incentive to establish and enforce the capital adequacy of traders, including the collection of margin, i.e., deposits on the amount at risk in a trade.[15] Under Dodd-Frank, the regulatory agencies decide whether specific types of swaps must be cleared and designated clearing organizations (DCOs) must inform regulators about which types of swaps they plan to clear.[16] Also, DCOs must allow "non-discriminatory" access to clearing.[17] Swaps that U.S. regulators require to be cleared must be traded on a designated contract market, securities exchange, or swap execution facility.[18] Swaps do not have to be cleared or exchange traded if no existing entity lists a particular swap product.[19] Finally, Dodd-Frank imposes its reporting requirements for swaps, whether or not they are cleared.[20]

---

derivatives . . . . The bill[] require[s] regulators to impose capital requirements on swap dealers and 'major swap participants.'").

9 Dodd-Frank Act § 731(a).

10 *Id*. §§ 731(h)(3)(B), 764(h)(3)(B)(i)-(iii).

11 *Id*. §§ 731(e), 764(e)-(h).

12 *Id*. §§ 737, 763(h), 727(c).

13 *See Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps Under Regulation MC*, 75 Fed. Reg. 65882 (proposed Oct. 26, 2010) (to be codified at 17 C.F.R. pt. 242) (explaining some of the regulations that the Dodd-Frank Act imposes on swap transactions).

14 *See* RENA S. MILLER , CONG. RESEARCH SERV., R41715, CONFLICTS OF INTEREST IN DERIVATIVES CLEARING 1 (2011), *available at* http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1832&context=key_workplace ("Clearing is an institutional arrangement that helps protect against counterparty default. A DCO, or clearinghouse, clears and settles derivatives contracts between counterparties.").

15 *See* COMM. ON PAYMENT & SETTLEMENT SYS., BANK OF INT'L SETTLEMENTS, MARKET STRUCTURE DEVELOPMENTS IN THE CLEARING INDUSTRY: IMPLICATIONS FOR FINANCIAL STABILITY 57 (2010), *available at* http://www.bis.org/publ/cpss92.pdf ("Central clearing generally reduces systemic risk and therefore carries social benefits. Principally, it reallocates credit risks to an entity . . . whose dedicated role it is to manage those risks in a robust and transparent manner.").

16 Dodd-Frank Act §§ 723(h)(2)(A), 763(a)(1).

17 *Id*. § 763(a)(2)(B).

18 *Id*. §§ 723(e), 763(a)(2)(B).

19 *Id*. § 763.

20 *Id*. §§ 727, 731, 764.

II. CONGRESS DIRECTED U.S. REGULATORS TO IMPLEMENT DODD-FRANK-MANDATED REFORMS ON AN EXTRATERRITORIAL BASIS IN ORDER TO PROTECT U.S. INTERESTS

Dodd-Frank authorizes U.S. regulators to apply regulations promulgated under the statute to foreign subsidiaries of U.S. banks, foreign banks and to trades conducted outside of the United States that directly involve U.S. parties or substantially impact the U.S. economy. For example, Dodd-Frank regulations apply to any non-U.S. financial institution that enters into a swaps transaction with a U.S. counterparty, even if the transaction occurs outside of the United States.[21] Section 722(d) directs the CFTC—which oversees approximately eighty-five percent of the derivatives market covered by Dodd-Frank[22]—to regulate any activity that has a "direct and significant connection with activities in, or effect on, commerce of the United States."[23] Section 722(d) also directs the CFTC to regulate extraterritorial activities that contravene rules or regulations promulgated by the agency and that "are necessary or appropriate to prevent the evasion of any provision of this Act."[24]

U.S. regulators have already relied on the extraterritorial scope of the Dodd-Frank Act to regulate certain swaps activities that directly involve or directly threaten the interests of U.S. persons and/or the U.S. economy, even if these activities occur outside of U.S. territory. The CFTC will likely require non-U.S. financial institutions that trade on U.S. markets or with U.S. counterparties to register as SDs and to adhere to CFTC regulations.[25] Also, the CFTC's

---

[21] *See* COMMODITY FUTURES TRADING COMM'N & SEC. & EXCH. COMM'N, PUBLIC ROUNDTABLE TO DISCUSS INTERNATIONAL ISSUES RELATING TO THE IMPLEMENTATION OF TITLE VII OF THE DODD-FRANK ACT 155 (2011) [hereinafter ROUNDTABLE TO DISCUSS INTERNATIONAL ISSUES], *available at* http://www.sec.gov/news/press/2011/2011-151-transcript.pdf (testimony of Marcelo Riffaud) ("The minute you touch a U.S. person, as we've said repeatedly, you now have U.S. rules that will attach."); *id*. at 152 (testimony of Angie Karna) ("[W]hichever regulated entity directly deals with a U.S. client will be registered under Dodd-Frank."); *id*. at 64 (testimony of David Kelly) ("[I]f you're dealing with an American resident counterparty then it's pretty difficult to get yourself out of American regulation."); *see also* Stephen R. Smerek & Jason C. Hamilton, *The Long Arm of the Law: Morrison, Dodd-Frank, and the Extraterritorial Reach of U.S. Regulators*, SEC. REG. & L., Oct. 4, 2011, at 2, *available at* http://www.winston.com/siteFiles/Publications/PDFArtic2.pdf (noting that Dodd-Frank authorizes the SEC to regulate certain securities transactions conducted by foreign investors outside of the United States, i.e. transactions that have a foreseeable and substantial effect on the U.S. economy).

[22] Correspondence by Chris Young, Dir. of U.S. Pub. Policy, Int'l Swaps & Derivatives Ass'n (noting that although the CFTC and SEC have yet to finalize the definition of "swap" and "security-based swap," the CFTC will likely have jurisdiction over "[w]ell over 80%" of the derivatives market and probably close to 85% of the market) (on file with author).

[23] Dodd-Frank Act § 722(d)(i)(1).

[24] *Id*. § 722(d)(i)(2).

[25] CLEARY GOTTLIEB STEEN & HAMILTON LLP, DODD FRANK: ONE YEAR LATER: KEY CURRENT ISSUES FOR FINANCIAL INSTITUTIONS 29 (2011), *available at* http://www.cgsh.com/files/News/d3b7c782-5cae-4332-88be-358ac68b2156/Presentation/NewsAttachment/a072cdb4-5bc5-49ff-b34c-35a6

proposed margin collection requirements under Dodd-Frank apply to U.S. and foreign counterparties of a covered swap entity.[26] The Federal Deposit Insurance Corporation has proposed rules that would require foreign banks that have a small U.S. presence to submit "living wills"—outlines of how a company would be liquidated in the event of a failure—to U.S. regulators.[27] Finally, the proposed Volcker Rule, which seeks to prevent banks that receive federal assistance from engaging in proprietary trading or owning more than three percent of hedge funds and private-equity funds,[28] applies to any bank with even marginal connections to the United States.[29]

III. LARGE FINANCIAL INSTITUTIONS AND FOREIGN GOVERNMENTS HAVE ATTEMPTED TO ALTER THE PLAIN AND CONSTITUTIONAL EXTRATERRITORIAL REACH OF DODD-FRANK

Despite Congress's clear intent to apply Dodd-Frank-mandated reforms on an extraterritorial basis where U.S. interests or the stability of the U.S. economy are at risk, Too Big to Fail Banks and their allies have opposed any application of Dodd-Frank outside of the United States. For example, Sally Miller, Chief Executive of the Institute of International Bankers, has complained that the proposed version of the Volcker Rule would "reach far beyond the shores of the US and apply . . . to all of the global activities of every foreign bank that

---

2d910c56/CGSH%20Alert%20-%20Dodd-Frank%20-%20One%20Year%20Later.pdf; *see also* Matt Cameron, *US Banks Could Lose Competitive Edge in Europe, Says EIB*, RISK MAG., Mar. 9, 2012, http://www.risk.net/risk-magazine/news/2156305/banks-lose-competitive-edge-europe-eib ("US swaps rules governing central clearing and bilateral collateralisation contain no exemptions for non-US sovereigns, central banks and multilateral development banks, unlike European derivatives rules, which exclude those entities from the scope of the regulation.").

[26] CLEARY GOTTLIEB STEEN & HAMILTON LLP, PRUDENTIAL REGULATORS PROPOSE SWAP MARGIN AND CAPITAL REQUIREMENTS 2 (2011) [hereinafter SWAP MARGIN AND CAPITAL REQUIREMENTS], *available at* http://www.cgsh.com/files/News/482d3044-e328-46d2-8f7e-f3c2676e03e4/Presentation/NewsAttachment/26f3059e-4a89-4ffa-938f-f501552fb8fb/CGSH%20Alert%20-%20Prudential%20Regulators%20Propose%20Swap%20Margin%20and%20Capital%20Requirements.pdf ("The proposed margin collection requirements would generally apply to U.S. and non-U.S. domiciled counterparties of a covered swap entity."); *see also* CLEARY GOTTLIEB STEEN & HAMILTON LLP, *supra* note 25, at 38 ("The Federal banking agencies have proposed to apply U.S. margin requirements to transactions by separately incorporated foreign subsidiaries of U.S. persons . . . with other foreign persons, even when the subsidiary does not have a guarantee from its U.S. parent.").

[27] Suzanne Kapner et al., *Overseas Banks Pursue 'Living-Will' Exemption*, WALL ST. J., Sept. 14, 2011, at C1.

[28] *See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Covered Funds*, 77 Fed. Reg. 8332 (proposed Feb. 14, 2012) (to be codified at 17 C.F.R. pt. 75) (describing the proposed rule as "contain[ing] certain prohibitions and restrictions on the ability of a banking entity and nonbank financial company supervised by the Board of Governors of the Federal Reserve System . . . to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund").

[29] Yalman Onaran, *Bank Lobby Widened Volcker Rule, Inciting Foreign Outrage*, BLOOMBERG (Feb. 23, 2012, 2:56 PM), http://www.bloomberg.com/news/2012-02-23/banks-lobbied-to-widen-volcker-rule-before-inciting-foreigners-against-law.html.

maintains even so much as a small branch in the US."[30] Miller also complained that the extraterritorial scope of U.S. financial regulations grossly exceeds the scope of foreign regulations: "none of the foreign regulators has proposed applying its local restrictions to the internal activities of US banks operating within America. One could only imagine the response of US regulators were the situation reversed."[31] In this respect, the financial industry has lobbied for a change to Dodd-Frank that would limit that statutes reach to the sovereign borders of the U.S. even when U.S. institutions and U.S. interests are at stake.

Similarly, several non-U.S. banks have protested the extraterritorial reach of Dodd-Frank reforms, even when these reforms seek to protect the United States's economic welfare. For example, Norinchukin Bank in Japan has argued that banning foreign banks with U.S. offices from engaging in proprietary trading "seems an excessive and extra-territorial application which deviates from one of the main objectives of the Dodd-Frank Act, namely, containing systemic risks."[32] Also, the European Investment Bank (EIB) and the European Central Bank (ECB) have threatened not to trade OTC swaps with U.S. banks if they are subject to Dodd-Frank's clearing and bilateral collateralization requirements.[33] The banks argue that development and central banks pose no risk to the economy.[34] To the extent that EIB and ECB's OTC swaps trades do not threaten U.S. interests, the banks should not have to comply with Dodd-Frank regulation; however, trading by those banks that involves U.S. persons and/or imposes risk on U.S. taxpayers and/or threatens the U.S. economy falls within Dodd-Frank's regulatory purview.

Further, Wall Street and the City of London have mobilized international governments and governing bodies to oppose the extraterritorial reach of Dodd-Frank financial reforms.[35] For example, Michel Bernier, the E.U.'s Financial Services Commissioner, has argued that it is not "acceptable that U.S. rules have such a wide effect on other nations."[36] Similarly, Richard Coffman, general counsel for the Institute of International Bankers, complained that "the proposed version [of the Volcker Rule] basically exports the . . . rule to our banks' home country operations . . . . The only way they could avoid the rule's reach is by de-

---

[30] Sally Miller, *Why Non-US Regulators Are Not happy with the 'Volcker Rule'*, FIN. TIMES, Feb. 21, 2012, http://www.ft.com/intl/cms/s/0/50d2c224-58b5-11e1-b9c6-00144feabdc0.html#axzz1pHeQoE5H.

[31] *Id*.

[32] Mark Gongloff et al., *Volcker Rule Hurts Wall Street, Bankers Warn*, HUFFINGTON POST (Feb. 13, 2012), http://www.huffingtonpost.com/2012/02/13/volcker-rule-wall-street_n_1274796.html.

[33] Cameron, *supra* note 25.

[34] *Id.*

[35] *See* Onaran, *supra* note 29 (reporting that U.S. banks and their lobbyists have been in regular contact with foreign governments regarding the proposed Volcker Rule and have warned these governments of the rule's potential impact on international markets).

[36] *Id.*

banking from the U.S."[37] The criticism by foreign governments has diversified opposition to the extraterritorial scope of Dodd-Frank regulations and intensified pressure on U.S. regulators to limit the reach of U.S. financial reforms as these reforms are designed to protect U.S. interests abroad as well as at home.[38]

Finally, foreign banks have suggested that U.S. clearing requirements would reduce U.S. banks' competitiveness in Europe. As Eila Kreivi, director of capital markets at the EIB in Luxembourg, explained: "If you were faced with the choice between trading with a counterparty with which you would be forced to clear the trade, and one with which the trade would remain uncleared, the choice of counterparty is an easy one, all other things remaining equal."[39] Thus, foreign banks have allied themselves with Wall Street to argue that Dodd-Frank regulations will hamper the competitiveness of the U.S. banking industry and, subsequently, negatively impact U.S. economic growth.[40] This argument overlooks the essential fact that the purpose of Dodd-Frank derivatives regulation was not to make U.S. banks more competitive with their foreign counterparts, but to protect the U.S. taxpayer from bailing out domestic and foreign banks in order to prevent the next worldwide financial Depression.

IV. THE EXTRATERRITORIAL SCOPE OF THE DODD-FRANK ACT SATISFIES DUE PROCESS OF LAW AND ALIGNS WITH ESTABLISHED REGULATORY PRACTICES

Despite the opposition to the application of Dodd-Frank reforms on an extraterritorial basis, Section 722(d) aligns with U.S. constitutional principles and established U.S. regulatory practice. Specifically, the extraterritorial reach of the Dodd-Frank Act satisfies the Due Process requirements of the Fifth and Fourteenth Amendments to the U.S. Constitution and accommodates U.S. regulators' demonstrated ability, when demonstrating personal jurisdiction, to sue foreign entities in U.S. courts for harms caused to U.S. citizens and to the United States.

A. U.S. Regulators Have Personal Jurisdiction Over Foreign Financial Institutions That Trade With U.S. Persons and/or Harm the U.S. Economy

The Due Process Clause protects "against inconvenient litigation" and limits the authority of U.S. state and federal courts "to render a valid personal

---

[37] *Id*.
[38] *Id*. (reporting that "[t]he global reaction has been extraordinary" according to Karen Petron, managing partner at Federal Financial Analytics).
[39] Cameron, *supra* note 25.
[40] *See Dimon on Price Wars, Volcker Rule, Stock Prices* (Fox Business broadcast Feb. 13, 2012), *available at* http://video.foxbusiness.com/v/1450367194001/dimon-on-price-wars-volcker-rule-stock-prices/ (claiming that Dodd-Frank regulations will drive swaps trades overseas).

judgment against a nonresident defendant."[41] Despite the restrictions imposed by Due Process, the Supreme Court has held that state and federal courts[42] may assert personal jurisdiction over non-residents.[43] In *International Shoe Co. v. Washington*, the Court explained that "due process requires only that in order to subject a defendant to a judgment in personam, if he be not present within the territory of the forum, he have certain minimum contacts with" the forum.[44] Also, in *World-Wide Volkswagen Corp. v. Woodson*, the Court observed that "if the sale of a product . . . arises from the efforts of . . . [a business to market] its product in other States, it is not unreasonable to subject it to suit in one of those States" if the product caused an injury in the state.[45]

In *Asahi Metal Industry Co. v. Superior Court of California*,[46] the Supreme Court relied on the minimal contacts test to hold that U.S. courts have jurisdiction over foreign owned and operated corporations. Asahi was a Japanese manufacturer that, prior to the lawsuit, had supplied valve assemblies to a Taiwanese company that manufactured tubes for use in the wheels of Honda vehicles. The plaintiff was injured when one of these tubes burst.[47] The Supreme Court issued a fractured decision, effectively explaining two standards for establishing personal jurisdiction. Justice O'Connor, writing the plurality opinion, concluded that "minimum contacts must come about by an action of the defendant purposefully directed toward the forum State."[48] Alternatively, Justice Brennan concluded that "Asahi's regular and extensive sales of component parts to a manufacturer it knew was making regular sales of the final product in California" satisfied the minimum contacts test established under the Due Process Clause.[49] The application of Dodd-Frank regulations to foreign subsidiaries of U.S. bank holding companies, to foreign persons who trade with U.S. counterparties, and/or to activities that have a "direct and significant

---

[41] World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 291-92 (1980).

[42] *See* RICHARD L. MARCUS ET AL., CIVIL PROCEDURE: A MODERN APPROACH 727 (4th ed. 2008) (commenting that "jurisdictional problems are identical in state and federal Court"); *see also* FED. R. CIV. P. 4(k)(1)(A) (stating that "[s]erving a summons or filing a waiver of service establishes personal jurisdiction over a defendant" in federal court if the defendant "is subject to the jurisdiction of a court of general jurisdiction in the state where the district court is located"); Pennoyer v. Neff, 95 U.S. 714, 722 (1878) (observing that "[t]he several States of the Union" operate like nation-states in that they "possess and exercise the authority of independent States").

[43] *See Pennoyer*, 95 U.S. at 720, 723 (holding that "the authority of every tribunal is necessarily restricted by the territorial limits of the State in which it is established," but recognizing that "the exercise of the jurisdiction which every State is admitted to possess over persons and property within its own territory will often affect persons and property without it"); *World-Wide Volkswagen*, 444 U.S. at 293-94 (abandoning the principle that personal jurisdiction is confined by territorial limits, while "stress[ing] that the Due Process Clause ensures . . . fairness . . . [and] the 'orderly administration of the laws'").

[44] 326 U.S. 310, 316 (1945).

[45] 444 U.S. at 297.

[46] 480 U.S. 102 (1987).

[47] *Id. at* 105-06.

[48] *Id*. at 112 (emphasis omitted).

[49] *Id*. at 121.

connection with . . . or effect on, commerce of the United States"[50] finds their clearest acceptance under the O'Connor standard described above; however, the regulations are drafted such that they will satisfy any of the aforementioned Supreme Court due process analyses. The Supreme Court's minimal contacts test authorizes U.S. regulators to protect the interests of U.S. persons[51] by regulating foreign institutions that "benefit economically"[52] from conducting business with such persons. Similarly, the test authorizes U.S. regulators to sue non-U.S. financial institutions whose swaps trading practices harm the financial interests of the United States.

B. U.S. Regulators Have Successfully Sued Non-U.S. Companies for Violating U.S. Financial Regulations

Enforcement actions by U.S. regulators against foreign financial institutions conducting business wholly outside the United States comport with the extraterritorial application of Dodd-Frank regulations to protect vested U.S. interests. For example, on May 11, 1998, the CFTC issued an order accepting a settlement from Sumitomo Corporation of Japan for manipulating the price of copper in violation of Sections 6(c), 6(d), and 9(a)(2) of the Commodity Exchange Act (CEA) through transactions that took place wholly outside of the United States.[53] The CFTC found that a rogue trader at Sumitomo's principal place of business in Tokyo, Japan, maintained large and dominating futures positions in copper metal on the London Metals Exchange (LME), and that these wholly foreign transactions directly and substantially impacted copper prices and markets in the United States.[54] The CFTC found that Sumitomo's manipulation of copper prices on the LME "caused prices on the [U.S.] Comex [and U.S. cash market] to become similarly distorted and artificial."[55] The order accepted Sumitomo's offer of settlement of $150 million for the CFTC's findings, to which Sumitomo neither admitted nor denied, and ordered Sumitomo to cease and desist from further violations of the CEA.[56] The CFTC's success sanctioning Sumitomo for violating U.S. commodities laws proves that the extraterritorial reach of the Dodd-Frank Act merely codifies U.S. regulators' existing authority to instigate proceedings against non-U.S. companies whose actions directly harm U.S. citizens and/or negatively impact the U.S. economy.

---

[50] Dodd-Frank Act § 722(d)(i)(1).
[51] *See* Pennoyer v. Neff, 95 U.S. 714, 723 (1878) ("Every State owes protection to its own citizens . . . .").
[52] *Asahi Metal Indus. Co.*, 480 U.S. at 121.
[53] *See* Press Release, CFTC No. 4144-98, CFTC Files and Settles Action Against Sumitomo Corporation For Manipulating the Copper Market in 1995-96 (May 11, 1998), *available at* http://www.cftc.gov/opa/enf98/opa4144-98.htm.
[54] *See* Sumitomo Corp., CFTC No. 98-14 (1998), *available at* http://www.cftc.gov/ogc/oporders98/ogcfsumitomo.htm.
[55] *Id*.
[56] *See* Press Release, *supra* note 53.

Further, far from complicating the extraterritorial application of Dodd-Frank swaps regulations,[57] the Supreme Court's 2010 ruling in *Morrison v. National Australia Bank Ltd.*[58] upholds Congress's authority to implement U.S. regulations across multiple jurisdictions in situations involving a U.S. citizen and/or that threaten the U.S. economy. *Morrison* was a securities case that involved a class action lawsuit in which foreign shareholders of National Australia Bank sued the bank in U.S. District Court.[59] The plaintiffs alleged that the fraudulent actions of an American mortgage company (HomeSide Lending, Inc.) owned by National Australia Bank violated Section 10(b) of the Securities Exchange Act[60] and that this violation caused a dramatic drop in the bank's share price.[61] The Court's decision hinged on a matter of statutory interpretation.

The Court in *Morrison* explained that a statute must "clearly express" Congress's "affirmative intention" to apply the statute extraterritorially.[62] It denied the plaintiffs relief based on the fact that the language of the Securities Exchange Act, as it existed prior to the passage of Dodd-Frank, did not establish such an affirmative intent.[63] The Court concluded that Section 10(b) applies only to "purchases and sales of securities in the United States" or "transactions in securities listed on domestic exchanges."[64]

Despite the outcome of *Morrison*, the Court maintained that Congress may legislate on an extraterritorial basis. The Court emphasized that the presumption against the extraterritorial application of statutes is "a canon of construction, or a presumption about a statute's meaning, rather than a limit upon Congress's power to legislate."[65] Congress exercised this power when, in Section 929P of Dodd-Frank, it rebutted the presumption against extraterritoriality in *Morrison* and authorized the SEC and Department of Justice to apply U.S. securities laws across jurisdictions.[66] Congress also exercised its

---

[57] *See* Smerek & Hamilton, *supra* note 21, at 4 (claiming that the Supreme Court's decision in *Morrison* renders the "impact of the Dodd-Frank Act regarding the extraterritorial application of U.S. securities laws . . . far from certain").
[58] Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869 (2010).
[59] *Id*. at 2875-76.
[60] *See* 15 U.S.C. § 78j(b) (prohibiting the use of any manipulative or deceptive device "in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement"); *see also* 17 C.F.R. § 240.10b-5 (prohibiting any act or omission that results in "fraud or deceit upon any person, in connection with the purchase or sale of any security").
[61] *Morrison*, 130 S. Ct. at 2875-76.
[62] *Id*. at 2877.
[63] *Id*. at 2881 ("On its face, §10(b) contains nothing to suggest it applies abroad . . . .").
[64] *Id*. at 2884.
[65] *Id*. at 2877.
[66] *See* LUIS A. AGUILAR, SEC. & EXCH. COMM'R, STATEMENT BY COMMISSIONER: DEFRAUDED INVESTORS DESERVE THEIR DAY IN COURT 2 (2012), *available at* http://www.sec.gov/news/speech/2012/spch041112laa.htm (stating that Congress "fully restore[d] the ability of the Securities and Exchange Commission . . . and the Department of Justice . . . to bring enforcement actions under Section 10(b) in cases involving transnational securities fraud pursuant to the pre-*Morrison* tests of conduct and effect").

legislative power when, in Section 722(d) of Dodd-Frank, it clearly and plainly expressed its intent to apply Dodd-Frank regulations on an extraterritorial basis to protect U.S. interests—Congress unequivocally authorized U.S. regulators to initiate proceedings (assuming they have personal jurisdiction) against non-U.S. entities that adversely affect U.S. citizens and/or directly and significantly impact U.S. commerce.[67] Thus, the *Morrison* ruling in no way curtails the express extraterritorial application of Dodd-Frank reforms.

V. THE EXTRATERRITORIAL APPLICATION OF DODD-FRANK IS NECESSARY TO PROTECT U.S. TAXPAYERS FROM HAVING TO BAIL OUT WORLDWIDE FINANCIAL INSTITUTIONS THAT POSE A SYSTEMIC RISK TO THE U.S. ECONOMY

The implementation of Dodd-Frank on an extraterritorial basis when U.S. interests are directly involved or threatened would protect U.S. taxpayers from the risks posed by the unregulated and interconnected global derivatives market. The extraterritorial reach of Dodd-Frank promises to facilitate the creation of uniform, global financial regulations that will reduce the risk of regulatory arbitrage and protect U.S. taxpayers from having to bail out Too Big to Fail Banks that engage in risky trading practices either within or outside of the United States. Also, far from diminishing U.S. banks' competitiveness in the global marketplace, the extraterritorial scope of Dodd-Frank would improve the competitive position of U.S. financial institutions by restoring investor confidence in the U.S. derivatives market.

A. Dodd-Frank Regulations Must Be Applied on an Extraterritorial Basis to Protect U.S. Taxpayers From the Demonstrated Risks to the U.S. Economy Associated with the Global Derivatives Market

The extraterritorial scope of Title VII of Dodd-Frank accommodates the interconnectedness of the global derivatives market and provides U.S. regulators with the global reach they need to protect U.S. taxpayers from regulatory arbitrage and ensuing market volatility.[68] As Jamie Dimon, chief executive officer of JPMorgan Chase, recently commented, banks such as JPMorgan "move trillions of dollars a day around the world, usually for global clients."[69] In this

---

[67] Dodd-Frank Act § 722(d).

[68] ROUNDTABLE TO DISCUSS INTERNATIONAL ISSUES, *supra* note 21, at 43 (testimony of Wally Turbeville) ("Derivatives are ephemeral, they defy the notion of territoriality, they defy a lot of things—they defy understanding."); *Financial Regulatory Reform: The International Context: Hearing Before the H. Comm. on Fin. Servs.*, 112th Cong. 1 (2011) [hereinafter Brainard Testimony], *available at* http://financialservices.house.gov/UploadedFiles/061611brainard.pdf (testimony of Lael Brainard, Under Secretary for International Affairs, Dep't of Treasury) (commenting that today's financial markets are global and highly interconnected).

[69] *Dimon on Price Wars, Volcker Rule, Stock Prices*, *supra* note 40.

regard—and in light of the multi-billion dollar losses that JPMorgan recently incurred from synthetic derivatives trades made by its London subsidiary[70]—global derivatives trading entails considerable financial risk.[71] It involves multinational parent institutions that have integrated their financial resources with the resources of their foreign subsidiaries so as to remain competitive in the global derivatives market. Due to their significant cross-jurisdictional dealings, these multinational institutions threaten the stability of the U.S. economy.[72] Specifically, subsidiaries and/or affiliates of U.S. parent companies that operate outside of the United States and subsidiaries and/or affiliates of foreign parent institutions that operate within the United States directly threaten U.S. economic interests[73] and, therefore, should be subject to Dodd-Frank reform.

Major financial entities manage their cash on a global basis so that no clear operational separation exists between a U.S. parent and its foreign subsidiaries. Lehman Brothers, for example, consisted of almost 3000 legal entities that operated in fifty countries. At the time of Lehman's insolvency, the bank's affiliates had over three hundred outstanding creditor and debtor balances that totaled over $21 billion[74] and several of the bank's subsidiaries had difficulty identifying their specific assets and liabilities.[75] In this respect, a foreign subsidiary of a U.S. parent company constitutes an integral and indistinguishable part of the parent institution and so should be classified as a U.S. person or U.S. counterparty under Dodd-Frank as the plain language of that statute dictates.

The integrated accounting practices used by major U.S. financial institutions and their foreign subsidiaries allows for a foreign subsidiary's unmargined trades (backed by no capital reserves set aside for the trades) to undermine the stability of the U.S. parent. The American taxpayers' $183 billion

---

[70] Dawn Kopecki et al., *JPMorgan Loses $2 Billion on Unit's 'Egregious Mistakes'*, BLOOMBERG BUSINESSWEEK, May 11, 2012, http://www.bloomberg.com/news/2012-05-11/jpmorgan-loses-2-billion-as-mistakes-trounce-hedges.html.

[71] ROUNDTABLE TO DISCUSS INTERNATIONAL ISSUES, *supra* note 21, at 68 (testimony of Robert Cook) (arguing that "broad rules perhaps are best" because "activities in physical [commodities] and not in our country have a huge effect back into [the U.S.] market"); *see also* Gary Gensler, CFTC Chairman, Keynote Address on the Cross-Border Application of Dodd-Frank Swaps Market Reforms Before the 2012 FINRA Annual Conference (May 21, 2012) [hereinafter Gensler Keynote Address], *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-113 (observing that swaps have "concentrated and heightened risk in international financial institutions . . . [and] can contribute to quickly spreading risk across borders").

[72] Gensler Keynote Address, *supra* note 71 (observing that "[l]arge, international financial institutions are managed as an integrated web of legal entities" that share treasury, custodial, brokerage and depository functions).

[73] *See id.* ("When one affiliate of a large, international financial group has problems, it's accepted in the markets that this will infect the rest of the group. If a financial run starts on one part of a group, almost regardless of where it is around the globe, it invariably means a funding and liquidity crisis rapidly spreads to the entire consolidated entity.")

[74] *Id*.

[75] Richard J. Herring, *Wind-Down Plans as an Alternative to Bailouts: The Cross-Border Challenges*, *in* ENDING GOVERNMENT BAILOUTS AS WE KNOW THEM 125, 144-45 (Kenneth E. Scott et al. eds., 2010).

bailout of American International Group (AIG)[76] proves that the financial stability of even a major U.S. financial institution can be undercut by the irresponsible trading practices of a foreign subsidiary. AIG's British subsidiary, AIG Financial Products, sold vast numbers of synthetic derivatives on mortgage-backed securities. When the value of these securities plummeted in the fall of 2008, AIG owed billions of dollars to investors who had bet against these subprime mortgages being paid off.[77] As CFTC Chairman Gary Gensler has observed, AIG's "fast collapse . . . was sobering evidence of the markets' international connectedness. Sobering evidence, as well, of how transactions booked in London or anywhere around the globe can wreak havoc on the American public."[78] Foreign subsidiaries of U.S. parent institutions present a serious threat to the U.S. economy and should be subject to Dodd-Frank regulation even though these subsidiaries are located outside of the United States.

The failure of Barings Bank further proves that a foreign subsidiary's actions can easily bankrupt its parent institution. Barings had operated in the United Kingdom for over 230 years before its demise. In 1995, the bank collapsed after a rogue trader who operated out of the bank's Singapore subsidiary incurred losses of over $1 billion.[79]

The multi-billion dollar trading losses recently incurred by JPMorgan confirm that unregulated global swaps trading by the foreign subsidiaries of U.S. banks presents a significant risk to U.S. taxpayers and the U.S. economy. As previously mentioned, JPMorgan, the largest U.S. bank holding company,[80] is assuming at least $2 billion in losses from bad trades in complex synthetic credit derivatives that were made by a single trader—the "London Whale"[81]—in the bank's U.K. subsidiary. JPMorgan's multi-billion-dollar losses confirm that even sophisticated U.S. banks cannot effectively manage the risks associated with global swaps trading and that U.S. taxpayers are susceptible to bailing out U.S. banks whose future trades, as was true of the subprime meltdown trades, surpass the capital reserves of those U.S. bank holding companies or other large U.S.

---

[76] *Id*. at 156.

[77] *See* Peter Koeing, *AIG Trail Leads to London 'Casino'*, TELEGRAPH, Oct. 18, 2008, http://www.telegraph.co.uk/finance/financialcrisis/3225213/AIG-trail-leads-to-London-casino.html.

[78] *See Implementing Derivatives Reform: Reducing Systemic Risk and Improving Market Oversight*, *Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 112th Cong. (2012) (statement of Gary Gensler, CFTC Chairman), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-114.

[79] *How Leeson Broke the Bank*, BBC NEWS (June 22, 1999, 3:58 PM), http://news.bbc.co.uk/2/hi/business/375259.stm.

[80] *See* Jake Zamansky, *Wall Street Compensation and JP Morgan: It's Déjà Vu All Over Again*, FORBES (June 1, 2012), http://www.forbes.com/sites/jakezamansky/2012/06/01/wall-street-compensation-and-jp-morgan-its-deja-vu-all-over-again/.

[81] *JPMorgan May Lose $5 Billion On Derivatives, WSJ Reports*, BLOOMBERG (May 18, 2012), http://www.bloomberg.com/news/2012-05-18/jpmorgan-may-lose-5-billion-on-derivatives-wsj-reports.html; *see also* Jessica Silver-Greenberg & Nelson D. Schwartz, *JPMorgan Loss Is Said to Rise at Least 50%*, N.Y. TIMES, May 17, 2012, at A1.

financial institutions.[82] As Senator Tim Johnson, Chair of the Senate Committee on Banking, Housing, and Urban Affairs, has stated, JPMorgan's "massive trading loss is a stark reminder of the financial crisis of 2008 and the necessity of Wall Street reform."[83] This "massive" loss is also a reminder that Dodd-Frank—which imposes strict capital, margin and transparency requirements on swaps dealers[84]—must apply on an extraterritorial basis when U.S. economic interests are directly involved.

Despite the significant risks associated with swaps trading by globally integrated financial institutions, legislators have attempted to weaken the extraterritorial scope of Dodd-Frank. H.R. 3283 ("Swap Jurisdiction Certainty Act"), which is presently stalled (as a result of the "London Whale" trading fiasco) in the House Agricultural Committee,[85] would exempt swaps trades between the foreign subsidiaries of U.S. banks and other U.S. companies from the protections of Title VII of the Dodd-Frank Act.[86] For example, the bill would allow a foreign subsidiary of Goldman Sachs to conduct trillions of dollars of overseas swaps trades with the foreign subsidiaries of JPMorgan and/or General Motors without having to satisfy Dodd-Frank's capital, margin or transparency requirements.[87]

If it becomes law (and prior to the "London Whale" fiasco, it was sailing through the U.S. House on a bipartisan basis), H.R. 3283 would create a major loophole in Dodd-Frank[88] by encouraging banks to migrate their swaps business overseas. Large U.S. banks and corporations operate numerous foreign

---

[82] Jennifer Liberto, *CFTC Investigating JPMorgan Chase*, CNN MONEY (May 22, 2012), http://money.cnn.com/2012/05/22/news/economy/jp-morgan-senate/index.htm (explaining that U.S. banks like JPMorgan have "direct access to the Federal Reserve's discount window and federal deposit insurance").

[83] *Implementing Derivatives Reform: Reducing Systemic Risk and Improving Market Oversight*, *Hearing Before the S. Comm. on Banking, Housing, & Urban Affairs*, 112th Cong. (2012) (statement of Tim Johnson, Chair, S. Comm. on Banking, Housing, & Urban Affairs), *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Newsroom.PressReleases&ContentRecord_id=75aea17c-d90e-40e0-4809-0791b8d6bb74.

[84] *See* Barbara Roper, *Will JPMorgan's Loss Provide a Win for Wall Street Reform?*, HUFFINGTON POST BUS. (May 14, 2012), http://www.huffingtonpost.com/barbara-roper/jpmorgan-wall-street-reform_b_1516352.html#es_share_ended; *see also* Steven Pearlstein, *Why Do They Trade This Stuff Anyway?*, WASH. POST, May 20, 2012, at G1.

[85] Silla Brush, *Dodd-Frank Swaps Legislation Delayed After JPMorgan Trade Losses*, BLOOMBERG (May 5, 2012), http://www.bloomberg.com/news/2012-05-15/dodd-frank-swaps-legislation-delayed-after-jpmorgan-trade-losses.html.

[86] Swap Jurisdiction Certainty Act of 2012, H.R. 3283, 112th Cong. (2012) (defining an "agency or branch of a U.S. person located outside the United States" as a "non-U.S. person" and exempting transactions between non-U.S. persons and domestic swap dealers and/or their foreign affiliates from Dodd-Frank protections).

[87] *See* Michael Hirsh, *Why Wall Street Hasn't Changed—Part II*, INFORMING THE 99 PERCENT (Mar. 30, 2012), http://informingthe99percent.blogspot.com/2012/03/why-wall-street-hasnt-changed-part-ii.html.

[88] *See* Mark Gongloff, *Dodd-Frank Act Under Assault Again*, HUFFINGTON POST (Mar. 27, 2012), http://www.huffingtonpost.com/mark-gongloff/dodd-frank-act-under-assault_b_1383703.html.

subsidiaries throughout the world; consequently, they could easily route their swaps trades through their foreign subsidiaries in order to avoid U.S. financial regulation. Such a large-scale migration would cause the vast majority of swaps trades not to be cleared, exchange-traded or otherwise publicly reported, and, subsequently, would significantly reduce transparency and stability in the global derivatives market. Such a migration would also send financial jobs overseas, while continuing to expose U.S. taxpayers, consumers, and businesses to the demonstrated risks associated with foreign swaps transactions—risks that Congress sought to eliminate when it passed Dodd-Frank.

The subsidiaries of foreign banks that operate in the United States also threaten the stability of the U.S. economy, and Dodd-Frank correctly brings them under U.S. jurisdiction. U.S. taxpayers should not subsidize foreign banks that own subsidiaries in the United States for trades that place the U.S. economy (indeed the world economy) at risk.[89] For example, Norinchukin Bank, the same Tokyo-based bank that opposed the extraterritorial reach of the proposed Volcker Rule,[90] borrowed almost $22 billion of emergency funds from the Federal Reserve during the 2008 financial crisis.[91] As Professor Anat Admati of Stanford University has observed, the U.S. government should not provide a safety net for foreign banks to engage in risky derivatives trading.[92] Classifying the U.S. subsidiaries of foreign lending institutions as U.S. persons and subjecting these subsidiaries to Dodd-Frank regulation would protect the U.S. economy from systemic risk. Regulating U.S. subsidiaries of foreign institutions would also protect U.S. taxpayers from having to spend billions of dollars to save large and small banks all over the world, like U.S. taxpayers did—by way of, *inter alia*, the Federal Reserve's discount window—immediately after the 2008 financial crisis.[93]

Subjecting foreign subsidiaries of U.S. parents and U.S. subsidiaries of foreign banks to Dodd-Frank's requirements would help prevent U.S. taxpayers from subsidizing the poor choices of foreign jurisdictions that adopt permissive financial regulations. Foreign governments and taxpayers may choose to enact financial regulations that allow for undercapitalized and non-transparent trading in their jurisdiction; they may also choose to bail out banks that engage in this kind of risky trading. However, U.S. taxpayers must not be forced to bail out foreign institutions that engage in risky derivatives trades in jurisdictions that

---

[89] Onaran, *supra* note 29 (reporting that foreign banks from as far away as Singapore may receive support from the Federal Reserve during a financial crisis if they have even a minimal presence in the United States).

[90] *See* Gongloff et al., *supra* note 32, and accompanying text.

[91] Onaran, *supra* note 29.

[92] *Id*.

[93] Keoun & Torres, *supra* note 3 (reporting that in the aftermath of the 2008 financial crisis many foreign banks borrowed from the Federal Reserve's discount window: Dexia, a Belgian- and French-based bank, borrowed approximately $33.5 billion; Depfa Bank, based in Dublin and now owned by the German government, borrowed $24.5 billion; and the Bank of Scotland borrowed at least $11 billion).

adopt lenient financial regulations when these trades risk wreaking havoc on the U.S. economy.

B. The Extraterritorial Scope of Dodd-Frank Promises to Facilitate Standard Global Financial Regulation that Will Protect U.S. Citizens from Systemic Risk

Comprehensive and harmonious international financial regulation is best, and perhaps only, achieved by the timely implementation of Dodd-Frank. The extraterritorial scope of U.S. standards or their equivalent would facilitate robust global financial regulations that promise to protect the world's taxpayers from regulatory arbitrage while helping to ensure a level playing field for all of the world's financial institutions.

1. Implementing Dodd-Frank on an Extraterritorial Basis Will Provide the World's Taxpayers with Timely Protection from Regulatory Arbitrage

International coordination and cooperation during the rule-making process—as mandated by Section 719(c) of the Dodd-Frank Act[94]—has undoubtedly strengthened a uniform global financial regulatory template. However, limiting the extraterritorial scope of Dodd-Frank reforms risks complicating and even undercutting ongoing efforts to standardize derivatives regulation on an international basis.[95] Specifically, the jurisdiction-by-jurisdiction financial reform advocated by Wall Street, the City of London, foreign banks and governments, and their allies would produce multiple, rather than uniform, regulatory regimes throughout the world. In turn, these regimes would prove difficult, if not impossible, to cohere into a comprehensive, global financial regulatory regime that can restore stability to the world's $700 trillion derivatives market.

Even assuming that international regulators could achieve consensus on common, international financial regulations, in the absence of appropriate extraterritorial reach of Dodd-Frank, harmonizing U.S. and foreign regulations would expose American taxpayers, businesses, and consumers to significant economic risk for years—if not decades. Although many jurisdictions are using the Dodd-Frank statutory framework for a regulatory template,[96] non-U.S.

---

[94] Dodd-Frank Act § 719(c)(1)(A)-(B) (requiring the CFTC and SEC to study swap and clearinghouse regulations in European and Asian jurisdictions and to identify areas where these regulations might align with U.S. rules for financial markets).

[95] Letter from Timothy Geithner, Sec'y of the Treasury, to Congressman Spencer Bachus (Sept. 14, 2011) [hereinafter Geithner Letter] (explaining that the SEC and CFTC have studied the international implications of Dodd-Frank regulations and are working with their European and Asian counterparts to produce comparable financial regulations) (on file with author).

[96] Geithner Letter, *supra* note 95, at 1 (commenting that Dodd-Frank is "set[ting] the global standard for oversight and transparency in the derivates market"); *see also* Brainard Testimony, *supra* note 68, at 1; COMMODITY FUTURES TRADING COMM'N STAFF, DERIVATIVES REFORM:

jurisdictions have not gotten heavily into the arduous process of translating statutory principles into operational regulations. For example, the United Kingdom has indicated that it may not implement the general reforms recently stipulated by the Independent Commission on Banking until 2019, when the new rules established by the Basel III international agreement on capital held by banks must come into effect.[97] The European Union is in a similar position: It has enacted financial reform legislation, but has only recently begun the rule-making process.[98] In this respect, denying Congress's express directive to apply Dodd-Frank extraterritorially to transactions involving U.S. parties or the stability of the U.S. economy invites the kind of discombobulated global financial regulation that would expose U.S. taxpayers to the risks associated with derivatives trading for the foreseeable future.

Additionally, international regulatory organizations have proposed global standards for financial reform. For example, the International Organization of Securities Commissions (IOSCO) recently released a report entitled *International Standards For Derivatives Market Intermediary Regulation* in which it observes that "[c]ross-border consistency among market authorities . . . is essential to successful oversight of the global OTC derivatives market."[99] The report offers

---

COMPARISON OF TITLE VII OF THE DODD-FRANK ACT TO INTERNATIONAL LEGISLATION (2010), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/speechandtestimony/gmac_100510-cftc2.pdf (noting that the European Commission's laws governing over-the-counter derivatives align with principles established by Dodd-Frank and that Europe is preparing to implement Dodd-Frank's two-tiered registration scheme); FIN. SERVS. AGENCY, GOV'T OF JAPAN, NEW REGULATION OF OTC DERIVATIVES IN JAPAN (2010), *available at* http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/gmac_100510_fsag.pdf (stating that in May of last year Japan amended its Financial Instruments and Exchange Act to adopt similar reporting and clearing requirements to the United States); George Mathew, *Optimistic About Parliament Passing FCRA Amendment Bill in Next Session*, INDIAN EXPRESS, June 27, 2011, http://www.indianexpress.com/news/optimistic-about-parliament-passing-fcra-amendment-bill-in-next-session/809040/2 (reporting that the Indian parliament was debating legislation that, like Dodd-Frank, would restore transparency to OTC markets).

[97] Robert Peston, *Banks Face Biggest Shake-Up for Decades*, BBC NEWS (Sept. 12, 2011), http://www.bbc.co.uk/news/business-14877861; *see also* Mark Hoban, Fin. Sec'y to the Treasury, *Britain Still Leads Critical Financial Reform Talks*, TELEGRAPH, Feb. 19, 2012, http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9091829/Britain-still-leads-critical-financial-reform-talks.html ("While we support what has been agreed to date, there remains much work to do.").

[98] *See* ATLANTIC COUNCIL & THOMSON REUTERS, THE DANGER OF DIVERGENCE: TRANSATLANTIC COOPERATION ON FINANCIAL REFORM I (2010), *available at* http://www.brookings.edu/~/media/Files/rc/reports/2010/1007_atlantic_council_elliott/1007_atlantic_council_elliott.pdf (commenting that while Europe is still considering major financial-reform legislation, the U.S. "has already set a framework to address the root causes" of the 2008 financial crisis); *Laws For All: Lots of Rules, But Not All Good Ones*, ECONOMIST, Feb. 18, 2012, http://www.economist.com/node/21547835 (reporting that the European Commission has issued over twenty proposed rules that are at different stages in the legislative process—forthcoming, under negotiation, and adopted—but that overall E.U. regulations are fragmented and trail U.S. efforts to regulate derivatives trading under Dodd-Frank); John O'Donnell, *EU Considers New Controls for Shadow Banking*, REUTERS, Mar. 19, 2012, *available at* http://www.reuters.com/article/2012/03/19/us-eu-shadowbanking-idUSBRE82I0KM20120319 (reporting that the E.U. has been criticized for being "slow to tackle the causes of a financial crisis that struck Europe roughly five years ago").

[99] INT'L ORG. OF SEC. COMM'NS, INTERNATIONAL STANDARDS FOR DERIVATIVES MARKET

fifteen recommendations regarding intermediaries in the swaps market that are similar to U.S. regulations. For example, the report recommends that market intermediaries register with market regulators and that intermediaries be subject to margin and capital requirements.[100]

IOSCO's report represents an important step toward harmonizing global financial regulation; however, the report's recommendations are vague—they offer general principles without providing the details necessary for the successful implementation of global financial reforms—and its survey of different jurisdictional approaches to market reform confirms that the United States remains well ahead of other jurisdictions with respect to derivatives reform. For example, IOSCO recommends that market intermediaries "should be subject to business conduct standards designed to ensure they operate in an ethical manner . . . [and] be strictly prohibited from engaging in any illegal or abusive practices."[101] In contrast, the CFTC has adopted specific prohibitions against fraud, manipulation, and other market abuses, and requires swaps parties to communicate in good faith.[102] Also, IOSCO reports that while "[s]ome jurisdictions are in the process of developing recordkeeping requirements" for market intermediaries, the CFTC is the only market authority that already has adopted rules that will require market intermediaries to submit specific documentation to a trade repository.[103] Finally, IOSCO identifies the CFTC's "robust standards for business supervision"[104]—the monitoring of trades, risk management procedures, conflict of interest controls, and qualifications for supervisors—as a model for the majority of jurisdictions that have yet to develop business supervisory obligations of any kind.[105]

In contrast to European and other international financial reform efforts, U.S. regulators are on the brink of completing the complex Dodd-Frank "implementation" stage and are on a glide path to regulate derivatives by as early as the end of 2012.[106] Although the CFTC failed to finalize its rules by the July 16, 2011, deadline set by Congress[107] and has continued to push back internal

---

INTERMEDIARY REGULATION 1 (2012), *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD381.pdf.

[100] *Id*. at 9, 16-17; *see also id*. at 1 (stating that the report's recommendations pertain to substantive areas such as business conduct, capital, registration, and recordkeeping standards).

[101] *Id*. at 22.

[102] *Id*. at 20; *see also* 17 C.F.R. § 23.410 (2012).

[103] *Id*. at 32.

[104] *Id*. at 28.

[105] *Id*. at 26.

[106] *The Commodity Futures Trading Commission 2012 Agenda*, *Hearing Before the H. Comm. on Agriculture*, 112th Cong. 1 (2012) (testimony of CFTC Chairman Gary Gensler) [hereinafter Gensler Testimony], *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-105 ("It's my anticipation that we will finish most of the rule-writing work by this summer; however, it's possible that a handful won't be finished until later this year.").

[107] *Derivatives Reform: The View From Main Street*, *Hearing Before the H. Comm. on Agriculture*, 112th Cong. 1 (2011) (testimony of CFTC Chairman Gary Gensler), *available at* http://agriculture.house.gov/transcripts/112/112-22.pdf.

deadlines,[108] CFTC Chairman Gary Gensler has repeatedly stated that his agency will likely finalize almost all of its financial regulations by late 2012.[109]

Further, the strict and geographically limited jurisdiction-by-jurisdiction approach to financial regulation supported by Wall Street and its allies ignores the fact that the immense size of U.S. financial markets means that the appropriate extraterritorial reach of Dodd-Frank regulations will serve as a *de facto* global standard for derivatives regulation. In this sense, the extraterritorial application of Dodd-Frank reforms is an almost inevitable result of U.S. attempts to ensure that derivatives trading is properly capitalized, collateralized and transparent. The United States government oversees approximately half of the world's now $700 trillion global derivatives market,[110] and most major foreign banks and financial entities participate in U.S.-regulated markets.[111] The dominant position of the U.S. derivatives market means that most global financial entities conduct swap transactions either in the United States[112] or with U.S. counterparties[113] and so will be subject to Dodd-Frank regulation. Also, the high-volume trades regularly conducted by global financial entities are likely to have "a direct and significant connection" with U.S. markets, even if the trades are transacted outside of the United States. Consequently, major foreign banks, despite their threats not to trade with U.S. counterparties, will register as SDs with the CFTC and develop internal practices that comply with U.S. trading requirements—these banks cannot afford to be sued in U.S. courts for violating

---

108 *Exclusive: CFTC Insiders Blow Whistle on Position Limit Rule*, THOMSON REUTERS, Sept. 14, 2011, *available at* http://newsandinsight.thomsonreuters.com/Securities/News/2011/09_-_September/Exclusive__CFTC_insiders_blow_whistle_on_position_limit_rule/ (reporting that the CFTC had already missed one deadline to finalize position limits and that CFTC Chairman Gary Gensler then hoped to have a position limits rule approved in early October 2011); *see also* Gensler Testimony, *supra* note 106 ("While the statute generally called for completion of the rules in one year, for most of them, it has taken us longer.").

109 *See* Gensler Testimony, *supra* note 106; *see also* Gensler Keynote Address, *supra* note 71 (commenting that the CFTC is "on schedule to complete the nearly 20 remaining reforms this year").

110 Karen Brettell, *Insight: Funds Battle Banks Over $300 Trillion Derivatives Market*, REUTERS, Nov. 22, 2011, *available at* http://www.reuters.com/article/2011/11/22/us-derivatives-regs-documents-idUSTRE7AL1CL20111122 (reporting that the market for privately traded derivatives in the United States was $300 trillion when the global market was estimated at approximately $600 trillion).

111 FED. RESERVE BANK OF N.Y., THE FOREIGN EXCHANGE AND INTEREST RATE DERIVATIVES MARKETS: TURNOVER IN THE UNITED STATES (2010), *available at* http://www.newyorkfed.org/markets/triennial/fx_survey.pdf; *see also Energy Market Manipulation and Federal Enforcement Regimes: Hearing Before the S. Comm. on Commerce, Sci., & Transp.*, 110th Cong. 5 (2008) (testimony of Michael Greenberger, Professor, Univ. of Md. Sch. of L.) (observing that major foreign futures exchanges trade in the United States on U.S.-based trading terminals of foreign-delivered futures contracts).

112 ROUNDTABLE TO DISCUSS INTERNATIONAL ISSUES, *supra* note 21, at 64 (testimony of Thomas Riggs III).

113 *Id*. at 99 (testimony of Marcelo Riffaud).

U.S. regulations or in any way risk not having access to the world's most lucrative market.[114]

2. Broad-Based U.S. Financial Regulation Will Preserve the Competitive Position of U.S. Financial Institutions in the Global Derivatives Market

The extraterritorial application of Dodd-Frank financial reforms will facilitate, not stymie, the competitiveness of U.S. banks and financial institutions. Implementing Dodd-Frank financial regulations on an extraterritorial basis when U.S. interests are directly at stake would standardize financial regulations for U.S. and large foreign financial institutions so that U.S. institutions would not be at a competitive disadvantage in the global marketplace. In this respect, the extraterritorial scope of Dodd-Frank would simultaneously prevent regulatory arbitrage and level the playing field between competing financial institutions located in different jurisdictions.

U.S. and European banks have often claimed that new financial rules will diminish their competitiveness in an attempt to avoid being subject to further regulation. U.S. banks argue that regulation under Dodd-Frank prevents them from competing with European banks; European banks argue that European financial regulations favor U.S. banks.[115] For example, U.S. and British banks oppose proposed margin and capital requirements in their respective jurisdictions for the same reason: the requirements (supposedly) impede international competitiveness.[116] At the same time, JPMorgan's Jamie Dimon has commented that the Basel III agreement is "un-American" and that it will compromise American banks' dominance in the global financial industry.[117]

---

[114] *See* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant", 75 Fed. Reg. 80,174 (proposed Dec. 21, 2010) (to be codified at 17 C.F.R. pt. 240) (noting that failure to register with the CFTC may result in enforcement action by the CFTC); Press Release, CFTC, CFTC Sues 11 Foreign Currency Firms in Second Nationwide Sweep Against Unregistered Firms (Sept. 8, 2011), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6108-11 (announcing that the CFTC sued eleven foreign currency firms for not registering under the 2008 farm bill, the Dodd-Frank Act, and the CFTC's own regulation).

[115] Barney Frank, Op-Ed, *A Thousand Cuts: In Bits and Pieces, Conservatives Attack Wall Street Reforms*, BOS. GLOBE, July 30, 2011, at 11.

[116] SWAP MARGIN AND CAPITAL REQUIREMENTS, *supra* note 26, at 2 (stating that U.S. banks complain that the extraterritorial application of Dodd-Frank-mandated margin requirements will "intensify the competitive disparities faced by U.S.-domiciled bank holding companies operating outside the U.S."); *Acclaim for Banking Shake-Up Plan*, BBC NEWS (Sept. 12, 2011), http://www.bbc.co.uk/news/business-14877865 (reporting that British banks considered capital requirements proposed by the British government to be "out of step with internationally agreed measures" and predicted the requirements will increase operational costs for British banks).

[117] Tom Braitwaite & Patrick Jenkins, *JP Morgan Chief Says Bank Rules 'Anti-US'*, FIN. TIMES, Sept. 12, 2011, http://www.cnbc.com/id/44481524/; Cheyenne Hopkins & Ian Katz, *Volcker Rule May Extend to Foreign Banks Operating in U.S.*, BLOOMBERG BUSINESSWEEK, Sept. 17, 2011, http://www.businessweek.com/news/2011-09-17/volcker-rule-may-extend-to-foreign-banks-operati

The ongoing fight between London-based Barclays Bank and the British government over financial reform in Britain epitomizes the banking industry's strategy of equating new regulation with loss of profits. Barclays has repeatedly threatened to relocate to the United States if the British government requires British banks to separate their high street retail operations from their investment banking work.[118] As Congressman Barney Frank has observed, the threats made by U.S. banks to migrate to the United Kingdom and the simultaneous threats by U.K. banks to migrate to the United States are reminiscent of "the 13-year-old son of divorced parents who tries to play Mommy off against Daddy."[119] The threats made by banks are both empty and divisive. They are intended to weaken financial regulation on both sides of the Atlantic. Again, the extraterritorial scope of Dodd-Frank has already served as a worldwide template for regulation. However, the United States has jump started this process and will help establish robust and uniform global financial reforms that will prevent major international banks from evading regulation by relocating their operations offshore.

VI. CONCLUSION

A failure to apply Dodd-Frank-mandated regulations to the trillions of dollars of swaps trading activities that take place outside the United States (but that directly and potentially adversely affect the U.S. economy) would expose the American public to the multifaceted and considerable risks associated with the interconnected, global derivatives market. Specifically, the limited application of Dodd-Frank regulations to the geographical United States would complicate the creation of the kind of robust international standards that would reduce the threat of regulatory arbitrage and, ultimately, a repeat of the 2008 financial crisis. In contrast, applying Dodd-Frank regulations on an extraterritorial basis where the U.S. has the appropriate contacts would facilitate the kind of robust, international financial reforms that are necessary to regulate today's integrated global market and, by extension, protect U.S. taxpayers from systemic financial risk while ensuring the competitiveness of U.S. financial institutions.

---

ng-in-u-s-.html (reporting that Wayne Abernathy, vice president of the American Bankers Association, complained that transactions conducted by American banks "can easily be done by foreign competitors").

118 *Don't Push Us to Leave UK, Barclays Warns Treasury*, THE WEEK, Mar. 21, 2011, http://www.thefirstpost.co.uk/76636,business,dont-push-us-to-leave-uk-barclays-warns-treasury (reporting that Barclays's former chief executive, John Varley, made a "thinly veiled threat" to British government officials that the bank would move its operations to the United States).

119 Adam Davidson, *Just Like Wall Street . . . Only Richer*, N.Y. TIMES, Mar. 4, 2012, at MM14.