GUARDING THE GUARDIANS: THE CASE FOR REGULATING STATE-OWNED FINANCIAL ENTITIES IN GLOBAL FINANCE

Stephen Kim Park*

Amidst the expansion of cross-border financial regulation, conspicuously missing from recent scholarly inquiries is the question of how institutions owned and controlled by governments, such as central banks, international financial institutions, and sovereign wealth funds, should be regulated in their capacities as market participants. The growth of these state-owned financial entities, coupled with the integral role of domestic and supranational regulators in promulgating, monitoring, and enforcing international financial rules, highlights a reversal of roles in the traditional regulatory framework—when governments as regulators become regulated subjects. This Article considers the legal and policy implications of this phenomenon by examining the application of the competing legal doctrines that govern this dynamic: extraterritorial application of domestic regulation versus the privileges and immunities under international law afforded to entities owned by a foreign government or multiple governments. The relative dearth of bright-line rules and the opaque nature of coordination mechanisms provide flexibility to regulators seeking to determine how to treat state-owned financial entities, but may also undermine the legitimacy of global financial regulation. As a case study, this Article examines the regulation of international financial institutions under the Dodd-Frank Act. To address the functional and normative shortcomings of the international financial architecture, I outline a global governance framework based on international comity to address the unique and wide-ranging implications of governments in the market.

INTRODUCTION

Among the many lessons learned in the aftermath of the recent financial crisis is the challenge of managing the globalization of financial markets. A wave of regulatory reforms across the globe has grappled with the effects of cross-border financial activities conducted by banks, funds, and other international pools of capital. Governments, acting alone and in coordination with their regulatory counterparts in other countries, may exercise this authority by applying domestic law to foreign firms and to such firms' cross-border and offshore activities. The convergence of these distinct yet inevitably intertwined phenomena—the rising volume of global capital flows and the desire to regulate foreign entities and activities—has weighty implications for the future of international law and the management of the global economy.

These developments have not come without controversy. The projection of domestic regulatory authority abroad raises normative and doctrinal questions about the future of national sovereignty in a global legal order in which private actors may be subject to the jurisdiction of multiple governmental authorities. This profoundly far-reaching debate, which has occupied scholars and practitioners alike for decades in areas such as corporate social responsibility, international human rights, and international trade regulation, has a newfound urgency due to the sheer size and magnitude of global financial markets and their spillover effects on the rest of the international economy.[1] Scholarly inquiry about its value, purpose, and proper scope may help clarify the legal mandates of domestic regulators and the strategic planning of financial institutions that function in this increasingly diverse and uncertain regulatory environment.

This Article identifies and explores an overlooked dimension in this debate: the status of market participants that are owned and/or controlled by the state. States participate in global financial markets alongside private actors. Indeed, the past few decades have witnessed the emergence and growth of market participants of an inherently public, governmental nature—among which include government agencies (such as finance ministries), central banks, and sovereign wealth funds, as well as international financial institutions such as the World Bank and International Monetary Fund (IMF) that are owned and governed by their member states.[2] These sovereign and supranational entities engage in a wide range of cross-border financial transactions with each other and private counterparties, including issuing debt, entering into derivative transactions, and investing in equities.

Despite the prominence of state-owned financial entities in the U.S. and foreign financial markets, their regulation has been, by and large, addressed in an *ad hoc*, piecemeal manner that reflects the absence of any kind of settled practice or binding legal principle. One reason is due to uncertainty about the extent to which privileges and immunities under international law apply to the market-based activities of these unique governmental entities. The doctrine of sovereign immunity provides that one state is not subject to the full force of rules applicable in another state.

---

* Assistant Professor of Business Law, University of Connecticut School of Business. Many thanks to family, friends, and colleagues for feedback and support. I wish to acknowledge the helpful insights of Chris Brummer, John Scott, and participants at the 2012 ALSB Annual Conference and the 2013 Philadelphia JILSA workshop. I also wish to thank the editors and staff of the University of Pennsylvania Journal of Business Law for their assistance. The views expressed in this Article and any errors and omissions are mine alone.

1. *See, e.g.*, David J. Bederman, *Diversity and Permeability in Transnational Governance*, 57 EMORY L.J. 201 (2007) (globalizing developments in the transnational legal order); Austen L. Parrish, *Rehabilitating Territoriality in Human Rights*, 32 CARDOZO L. REV. 1099 (2011) (globalization and territorial governance in international human rights); Chantal Thomas, *Should the World Trade Organization Incorporate Labor and Environmental Standards?*, 61 WASH. & LEE L. REV. (2004) (enforcement mechanisms in international trade law); Jonathan Turley, *"When in Rome": Multinational Misconduct and the Presumption Against Extraterritoriality*, 84 NW. U. L. REV. 598 (1990) (extraterritorial jurisdiction and statutory interpretation).

2. This Article refers to these entities collectively as "state-owned financial entities." This Article does not directly address state-owned banks and other state-owned enterprises whose missions and activities are generally not public in nature.

Similarly, the distinct yet related doctrine granting privileges and immunities to international organizations is well established in international law.[3] Nonetheless, as this Article shows, these doctrines are rife with ambiguity in practice due to the lack of clarity regarding the balancing of the sovereign prerogatives underlying regulatory authority and regulatory immunity.[4] International privileges and immunities—whether expressly cited or implicitly relied on—have an effect on the level and kind of regulatory authority to which foreign state-owned financial entities may be subject. In the United States, this phenomenon has been notably evident in ongoing administrative rulemaking pursuant to the Dodd-Frank Act.[5] The unsettled status quo underscores the potential for policy incoherence arising from discord between centuries-old principles of international law and the Bretton Woods-era international economic system vis-à-vis the rapidly-changing nature and scope of modern-day international finance.

International law—and the traditional framework of regulatory authority on which it is based—is premised on a command-and-control relationship between governments as regulators and private market participants as their regulated subjects. The juxtaposition of international privileges and immunities with extraterritorial regulation of foreign sovereign and supranational entities exposes disjunctures in this relationship. The consequences of inaction, albeit indirect, may be severe. Governance gaps may form if conflicts between these principles are resolved differently across jurisdictions, or there may be legal instability over time as regulators struggle to harmonize these principles to new kinds of state-owned financial entities and new kinds of financial activities. Perhaps the most troubling implication is the possibility of collective doubt among private market participants about the fundamental fairness of international privileges and immunities, which may damage the legitimacy of global financial regulation itself.

On a broader conceptual plane, global financial regulation reflects the changing environment of international business, in which private actors engage with each other as well as with states to proscribe standards of

3. This Article analyzes individually the privilege and immunity doctrines applicable to foreign governments and their instrumentalities and enterprises (hereinafter referred to as "sovereign immunity") and to international organizations (hereinafter referred to as "intergovernmental immunity"), and collectively refers to these doctrines as they may apply to either or both types of state-owned financial entities as "international privileges and immunities."

4. The concept of "regulatory immunity," as presented in this Article, describes the application of international privileges and immunities to regulatory authority exercised vis-à-vis a foreign government or an international organization.

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

conduct.[6] As a means of mediating the conflicts and concerns raised by the extraterritorial regulation of state-owned financial entities, this Article looks towards these new forms of global governance. While acknowledging their limitations, this Article suggests a framework based on coordinated standard-setting, mutual recognition, and interagency dialogue.

This Article explores these issues in three parts. Part I provides a brief overview of the extraterritorial dimensions of recent financial regulatory reforms, with a specific focus on the Dodd-Frank Act. As a means of evaluating the process and effects of global financial regulation, the doctrinal and institutional tools of extraterritorial regulatory authority are identified and examined. Drawing on recent scholarly insights in international economic law, traditional government-centric conceptions of domestic regulatory authority are compared to hybrid approaches that incorporate transgovernmental regulatory networks, international financial institutions, and non-state actors. Part II begins by describing the sizable and evolving role of state-owned financial entities as market participants in global financial markets. The cross-border financial transactions of these institutions reveal potential stress points in global financial regulation due to their unique status as sovereign and supranational entities. Part II proceeds by exploring the privileges and immunities enjoyed by these actors under international law, and then considers how claims of regulatory immunity may complicate the formulation and enforcement of global financial rules. The experience of international financial institutions in respect of the provisions of the Dodd-Frank Act regulating swap transactions is examined as an illuminating case study. Part III explores the ramifications of this inversion of the roles of the regulator and the regulated, identifying the systemic concerns that this phenomenon raises. Drawing on insights and critiques raised by scholarship on network theory, legal pluralism, and social constructivism, Part III outlines a framework of global financial comity as a means of facilitating the identification, expression, and resolution of institutional conflicts. These prescriptive measures, although in part a reflection of the unique status of state-owned financial entities, also reveal the extent to which questions of accountability and legitimacy permeate the governance of international business activities generally. In the Conclusion, I suggest ways in which the insights offered

6. This Article uses the term "global financial regulation" to refer to the regulation of foreign and transnational entities and cross-border financial activities, irrespective of its source or mode. The extraterritorial application of domestic financial rules by individual governments—most notably, the United States—is thereby linked with the distinct, relatively nascent area of financial regulation based on informal rules and regulatory coordination among multiple governments. *See infra* Part I.B.2.

in this Article may be more broadly applied to issues of financial regulation, global governance, and the future development of international law.

I. EXTRATERRITORIALITY AND THE STATE: THE EXPANDING REACH OF FINANCIAL REGULATION

Global financial regulation underscores the changing nature of state power. Economic globalization has transformed the means by which sovereignty is exercised and therefore the exercise of regulatory authority. The following discussion describes this evolving movement in the context of global financial regulation, which features the extraterritorial exercise of domestic regulatory authority coupled with the proliferation of transnational networks of regulators.

A. The Objectives and Limitations of Global Financial Regulation

The 2008 financial crisis revealed the extent to which financial actors, markets, and activities have moved offshore, beyond the territorial reach of domestic regulators. Although the U.S. subprime mortgage crisis that was its root cause was not inherently global in nature, the near-collapse of the world's financial system demonstrated the interconnectedness of global financial markets and the shortcomings of regulatory approaches to maintain stability and mitigate systemic risk.[7] Without a doubt, the financial crisis, reflecting the globalization of financial markets in the twenty-first century, was global in scope and effect.[8]

Globalization has increased both the breadth and depth of modern finance—the scope of cross-border financial activities is enormous and unprecedented.[9] In 2012, the size of international positions of banks was over U.S. $33 trillion, and the total amount outstanding of international

7. *See* Douglas W. Arner, *Adaptation and Resilience in Global Financial Regulation*, 89 N.C. L. REV. 1579, 1582-86 (2011) (providing a framework for analyzing systemic risk in the global financial system). Systemic risk, the avoidance of which is oft-cited as a key function of financial regulation, has three meanings: (1) the correlated exposure of institutions and markets to external shock; (2) the potential for a chain reaction of failures due to the interconnectedness of institutions through counterparty relationships; and (3) the problem of contagion due to the spread of failures (or the fear of failures) across different industries or sectors. HAL S. SCOTT, THE GLOBAL FINANCIAL CRISIS 11-12 (2009).

8. *See* Chris Brummer, *How International Financial Law Works (and How It Doesn't)*, 99 GEO. L.J. 257, 268 (2011) (describing "global" systemic risk).

9. *See* HAL S. SCOTT & ANNA GELPERN, INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATION 18-21 (19th ed. 2012) (analyzing the globalization of financial markets based on several metrics).

debt securities was approximately U.S. $21.6 trillion.[10] The nominal value of derivative contracts is staggering, amounting to U.S. $639 trillion in notional amounts outstanding and U.S. $25 trillion in gross market value.[11] In the United States, foreign entities (among which may include corporations, banks and other financial institutions, and governments) issue securities in the U.S. capital markets, which may be listed on a U.S. stock exchange or sold directly to U.S. purchasers under certain conditions.[12] Foreign banks may operate in the United States, either on a cross-border basis or through the establishment of domestic branches or subsidiaries.[13] Most notably, the over-the-counter (OTC) derivatives market—which was largely self-regulated in the United States prior to the Dodd-Frank Act—has been traditionally based on bilateral contracts between counterparties that may be domiciled anywhere.[14]

The regulation of global finance consists of two distinct types of governmental engagement: rulemaking and standard-setting, on the one hand, and prudential oversight and supervision, on the other.[15] Supervisory authority is further sub-categorized into traditional prudential supervision, which concerns the safety and soundness of individual financial entities, and macroprudential supervision, which addresses the stability of the entire financial system.[16] The risks resulting from regulatory gaps caused by antiquated domestic regimes and inadequate international coordination were exposed in unprecedented ways during the financial crisis and its aftermath.[17] The Dodd-Frank Act can be viewed as a direct response.[18]

10. Bank of International Settlements, *BIS Quarterly Review, Statistical Annex* (Dec. 10, 2012), *available at* http://www.bis.org/publ/qtrpdf/r_qs1212.pdf.

11. Bank of International Settlements, *BIS Quarterly Review, Highlights of the BIS International Statistics* (Dec. 10, 2012), *available at* http://www.bis.org/publ/qtrpdf/r_qt1212b.pdf. Derivatives—such as futures, options, and swaps—are financial instruments whose value is based on or derived from other assets or variables. The underlying asset may be anything from stock and bonds, to commodities, interest rates, currency rates, or a stock market index. Seema G. Sharma, *Over-the-Counter Derivatives: A New Era of Financial Regulation*, 17 LAW & BUS. REV. 279, 283-84 (2011).

12. SCOTT & GELPERN, *supra* note 9, at 91-93.

13. MICHAEL P. MALLOY, PRINCIPLES OF BANK REGULATION 395-400 (3d ed. 2011).

14. Arner, *supra* note 7, at 1584-85, 1602; Frank Partnoy, *The Shifting Contours of Global Derivatives Regulation*, 22 U. PA. J. INT'L ECON. L. 421, 422 (2001) (referring to the absence of regulation of many classes of derivatives).

15. *See* Eric J. Pan, *Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks*, 11 CHI. J. INT'L L. 243, 264 (2010) (noting the distinction between rulemaking and supervision). Supervision is the process by which regulators monitor the behavior of financial institutions and other market participants to ensure compliance with applicable rules and standards. *Id.* at 265-66.

16. Arner, *supra* note 7, at 1583-84.

17. *See id.* at 1610-11 (arguing that opportunities for regulatory avoidance and arbitrage, as well as a lack of transparency of complex global financial institutions, were a

Perhaps not surprisingly, given the global scope of the financial activities that regulators around the world have sought to address, appraisals of the Dodd-Frank Act evoke fundamental questions about the objectives and effectiveness of the state as regulator. According to certain impassioned observers, economic globalization has hastened the decline and eventual obsolescence of the modern Westphalian nation-state system.[19] Others cite the lack of a centralized enforcement authority as evidence of the collective action problems among sovereigns that have beset the nation-state system for centuries.[20] The fragmented nature of global financial regulation may also reflect the influence of private financial entities in rulemaking and standard-setting based on their narrow, self-interested objectives.[21] In this respect, the regulation of global finance may present unique challenges to state authority because of the unparalleled mobility of portfolio capital, deeply intertwined relationships between governments and their respective countries' banking sectors, and the consequential effect of risk across many distinct yet inter-connected counterparties.[22] Due to the predominantly territorial basis for regulatory authority in financial services, foreign entities may be subject to varying levels of regulatory oversight depending on the nature of their transactions, their domicile, or other factors, which may give rise to regulatory arbitrage

result of the structure of domestic, regional, and international regulation before the global financial crisis).

18. *See* Michael S. Barr, *The Financial Crisis and the Path of Reform*, 29 YALE J. ON REG. 91, 97-108 (2012) (explaining how the Dodd-Frank Act improved management of systematic risk).

19. *See, e.g.*, THOMAS FRIEDMAN, THE LEXUS AND THE OLIVE TREE: UNDERSTANDING GLOBALIZATION (1999) (suggesting that globalization has created a single global market that integrates capital, technology, and information across nations); *see also* Larry Catá Backer, *Economic Globalization Ascendant and the Crisis of the State: Four Perspectives on the Emerging Ideology of the State in the New Global Order*, 17 BERKELEY LA RAZA L.J. 141, 145-54 (2006) (describing one perspective of the state as increasingly dependent on non-state actors for power).

20. *See* David Zaring, *Finding Legal Principle in Global Financial Regulation*, 52 VA. J. INT'L L. 683, 701-16 (2012) (identifying shared and comparable characteristics of international financial law and the treaty-based hard international law regimes of the WTO and the EU).

21. *See* Michael Greenberger, *The Extraterritorial Provisions of the Dodd-Frank Act Protects U.S. Taxpayers from Worldwide Bailouts*, 80 UMKC L. REV. 1, 18-21 (2012) (arguing that the ineffectiveness and slow pace of foreign and international regulatory reform of OTC derivative markets warrants immediate, unilateral action by U.S. regulators).

22. *See* DANIEL W. DREZNER, ALL POLITICS IS GLOBAL 130-32 (2007) (describing the causes of inadequate regulation following the Latin American and East Asian financial crises of the 1990s); Joel P. Trachtman, *The International Law of Financial Crisis: Spillovers, Subsidiarity, Fragmentation and Cooperation*, 13 J. INT'L ECON. L. 719, 723 (2010) (describing the effects of regulatory competition on regulatory effectiveness).

and the so-called race to the bottom.[23] State regulatory power may be uniquely hampered in respect of foreign financial actors and their activities due to the latter's ability to move across borders.[24]

During the financial crisis, the absence of a global financial regulator with enforcement powers akin to the World Trade Organization (WTO) was glaring.[25] As a response, there have been renewed calls for the establishment of a treaty-based international regime of varying substantive scope and institutionalization.[26] The appeal of an intergovernmental body with lawmaking, monitoring, and coercive enforcement powers over financial activities is manifold.[27] Nonetheless, despite the shortcomings of the status quo and a desire to realize the broad aspirations of a post-Bretton Woods order, a global financial regulator appears highly unlikely for the foreseeable future. Among other factors, this is due to the benefits that governments accrue by retaining rulemaking and supervisory autonomy: namely, the prerogative to selectively apply or change policies and practices based on national interest, which may include the preferences of domestic financial interests and firms.[28] In any event, it is indisputable that

23. *See* Jonathan R. Macey, *Regulatory Globalization as a Response to Regulatory Competition*, 52 EMORY L.J. 1353, 1362 (2003) (defining regulatory arbitrage as the movement of market competitors to jurisdictions that are unregulated, lightly regulated, or otherwise have relatively favorable regulations); *see also* Trachtman, *supra* note 22, at 742 (describing a global "race to inappropriate laxity").

24. *See* Chris Brummer, *Post-American Securities Regulation*, 98 CAL. L. REV. 327, 379 (2010).

25. *See* Thomas Cottier, *Challenges Ahead in International Economic Law*, 12 J. INT'L ECON. L. 3, 14 (2009) (observing, *inter alia*, that the financial crisis showed that state-based regimes were wholly inadequate).

26. *See, e.g.*, DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES 186-87 (2011) (proposing an international treaty to govern the insolvency of financial institutions under the laws of the six most important countries); Barry Eichengreen, *Not a New Bretton Woods but a New Bretton Woods Process*, *in* WHAT G20 LEADERS MUST DO TO STABILISE OUR ECONOMY AND FIX THE FINANCIAL SYSTEM 25, 25-27 (Barry Eichengreen & Richard Baldwin eds., 2008), *available at* http://www.voxeu.org/sites/default/files/file/G20_Summit%20vox.pdf (calling for the creation of a World Financial Organization equivalent to the WTO with a broad rulemaking and supervisory mandate); Edward F. Greene & Joshua L. Boehm, *The Limits of "Name-and-Shame" in International Financial Regulation*, 97 CORNELL L. REV. 1083, 1130-33 (2012) (proposing a treaty-based framework for coordinating supervision and resolution of global systemically important financial institutions); Pan, *supra* note 15, at 273-77 (advocating for the creation of an international body responsible for cross-border supervision).

27. *See* Chris Brummer, *Why Soft Law Dominates International Finance—And Not Trade*, 13 J. INT'L ECON. L. 623, 641 (2010) (noting the structural flaws and shortcomings of soft law based global financial regulation in comparison to the enforcement powers of the WTO).

28. *See* CHRIS BRUMMER, SOFT LAW AND THE GLOBAL FINANCIAL SYSTEM: RULE MAKING IN THE 21ST CENTURY 269 (2011) (discussing the impracticability of having a single

the negotiation of an international treaty-based framework would be long and arduous due to the persistence of nationalistic and protectionist sentiments.[29]

B. Extraterritoriality as an Instrument of Regulatory Power

In light of newfound pressures on states arising from the globalization of finance, extraterritorial regulation offers various means to manage the activities of foreign financial institutions. The following discussion identifies and analyzes these approaches, and explores the concerns that are implicated by extraterritoriality. This overview is deliberately non-exhaustive, focusing on areas and issues of most relevance to state-owned financial entities.

1. How and To What Effect Extraterritorial Regulation is Exercised

A cornerstone of the international legal system is territoriality, based on the idea that each sovereign state has exclusive jurisdiction over its own territory.[30] Domestic territoriality both reflects and furthers the principle of sovereignty by circumscribing the reach of state authority while reinforcing the absolute power of every state within its own borders.[31] In accordance with this principle, U.S. financial law embraces the presumption that a country's laws apply only to acts or events occurring within its territory.[32]

One of the most profound changes in international relations has been the rise of extraterritoriality, or the extension of domestic law to activity outside of the country's territory.[33] In particular, the growing use of U.S.

global financial regulator).

29. *See* Eric C. Chaffee, *The Internationalization of Securities Regulation: The United States Government's Role in Regulating the Capital Markets*, 5 J. BUS. & TECH. L. 187, 197 (2010) (suggesting that despite the potential benefits of global regulatory harmonization of securities regulation, such process would be slow and evolutionary). This was arguably evident in the area of international trade regulation by the nearly five decades between the signing of the General Agreement on Tariffs and Trade (GATT) and the establishment of the WTO. *See* JOHN H. JACKSON, THE WORLD TRADING SYSTEM: LAW AND POLICY OF THE INTERNATIONAL ECONOMIC RELATIONS 35-44 (2d ed. 1997) (explaining the flawed constitutional beginnings of the GATT).

30. *See* Parrish, *supra* note 1, at 1100-01.

31. Anthony J. Colangelo, *Constitutional Limits on Extraterritorial Jurisdiction: Terrorism and the Intersection of National and International Law*, 48 HARV. INT'L L.J. 121, 127 (2007).

32. *See* BRUMMER, *supra* note 28, at 33-35.

33. *See* Austen L. Parrish, *Reclaiming International Law from Extraterritoriality*, 93 MINN. L. REV. 815, 841-56 (2009) (describing the displacement of treaty-based international law by transnational law).

Under international law, territorial jurisdiction includes subjective and objective domestic law to regulate conduct occurring beyond U.S. borders has been at the forefront of this wave. Transnational civil litigation in U.S. federal courts has been used to exert influence via judicial enforcement in a wide range of subject areas.[34] Through a variety of administrative agency rulemaking and enforcement mechanisms, the United States, more than any other country, has projected its regulatory authority extraterritorially.[35]

Mirroring these broad-based changes in other areas of global import, foreign financial institutions and offshore financial activities are increasingly governed by a web of domestic legal rules projected across national borders. In the United States, federal regulatory authorities—such as the Securities and Exchange Commission (SEC), the Commodities Futures Trading Commission (CFTC), and the Federal Reserve—supervise and proscribe certain conduct of foreign entities and offshore activities. Extraterritorial regulatory authority is exercised in a variety of distinct ways, reflecting a diverse array of public policy considerations.[36] Extraterritorial regulation falls into the following four categories, with illustrative examples from U.S. financial law and practice:

TARGETED FOREIGN REGULATION. Foreign entities may be subject to laws and/or administrative regulations directly and exclusively applied to them. This sort of blunt force approach is relatively rare and applied narrowly in global financial regulation due to its blatantly discriminatory nature.[37] Although this form of extraterritorial regulation is most

forms. Subjective territoriality provides a nation-state with jurisdiction over acts that occur within its territory that may have effects outside its territory. Objective territoriality—otherwise known as the "effects doctrine"—concerns conduct that occurs outside the nation-state that has, or is intended to have, effect within its territory. *See* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 402(1) (1987); PETER MALANCZUK, AKEHURST'S MODERN INTRODUCTION TO INTERNATIONAL LAW 110-11 (7th ed. 1997) [hereinafter Akehurst]. As further examined herein, the extrapolation of these principles is prevalent in the extraterritorial application of U.S. financial regulation.

34. *See* Parrish, *supra* note 33, at 846-49 (describing and citing the use of extraterritorial domestic law in antitrust, securities regulation, intellectual property law, corporate law, bankruptcy, tax, criminal law, environmental law, civil rights, and labor); *see also* Hannah L. Buxbaum, *Transnational Regulatory Litigation*, 46 VA. J. INT'L L. 251, 273-80 (2006) (critiquing the application of territorial principles in transnational regulatory cases).

35. *See* BRUMMER, *supra* note 28, at 44-45 (referring to U.S. regulatory dominance as most closely resembling *lex financiera*).

36. The overview of extraterritorial regulation that follows draws substantially from Chris Brummer's description of regulatory strategies based on extraterritorial territoriality and direct extraterritoriality. *See* Chris Brummer, *Territoriality as a Regulatory Technique: Notes from the Financial Crisis*, 79 U. CIN. L. REV. 499, 504-09 (2010) (describing the various regulatory tactics asserted under territorial authority).

37. *See id.* at 507 (noting that this form of extraterritorial regulation is "virtually non-

commonly associated with laws pertaining to international human rights laws, such as the Alien Tort Statute, it does intersect the financial sector with respect to entities and activities of a nature that implicate national security interests. For example, sanctions under U.S. law may be enforced against foreign central banks and other financial institutions wholly or partly owned by foreign governments that prevent such entities from transacting with American counterparties.[38] Also, the Committee on Foreign Investment in the United States (CFIUS), an inter-agency committee that is authorized to review foreign investment with national security implications, may block acquisitions of U.S. businesses by foreign persons.[39] A third example, the Foreign Corrupt Practices Act (FCPA), imposes civil liability and criminal sanctions on U.S. persons and certain foreign parties for bribery of foreign government officials, which may include representatives and agents of state-owned financial entities.[40]

QUASI-TERRITORIAL REGULATION. Foreign entities operating in the United States through affiliates, subsidiaries, and other instrumentalities are invariably subject to supervision and operational requirements by U.S. regulators, both at the federal and often state levels. Extraterritorial regulation of domestic financial activities by domestically-domiciled

existent" in the financial world due to the reluctance of courts to take on cases with little national security interest).

38. The Office of Foreign Assets Control (OFAC), an agency within the Department of the Treasury, administers and enforces economic and trade sanctions against targeted foreign countries, regimes, and other threats to the national security, foreign policy, or economy of the United States. OFAC has the authority to impose controls on transactions and freeze assets under U.S. jurisdiction. For example, OFAC prohibits U.S. depository institutions, including foreign branches, from servicing accounts of the government of Iran, including Iranian government-owned or -controlled banks. *See* Iranian Transactions Regulations, 31 C.F.R. § 560 (2012) (detailing the prohibition of supplying various types of goods and services to Iran, as well as defining the scope of the prohibition).

39. *See* Exec. Order No. 11,858, 3 C.F.R. 990 (1971-1975) (ordering the establishment of CFIUS and establishing its responsibilities and authority).

40. *See* DEPT. OF JUST. AND SEC. EXCH. COMM'N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT (2012), *available at* http://www.justice.gov/criminal/fraud/fcpa/guide.pdf. The FCPA neither specifically addresses nor excludes financial transactions or institutions, either as subjects or objects of prohibited conduct. Nonetheless, it is plausible that aggressive FCPA enforcement may have a material negative effect on the financial activities of foreign state-owned financial entities that engage with counterparties subject to the FCPA. *See* Brummer, *supra* note 36, at 507 (identifying the FCPA as an exception to the reluctance of courts to adjudicate extraterritoriality cases in the financial sector); *see also* Joshua Gallu, *SEC Probes Financial Firms on Sovereign Fund Bribes*, BLOOMBERG NEWS, Jan. 14, 2011, http://www.bloomberg.com/news/pring/2011001-14/sec-probes-financial-firms-on-possible-bribes-to-sovereign-wealth-funds.html (highlighting FCPA enforcement in respect of sovereign wealth funds).

foreign entities is particularly evident in two important areas of global financial regulation. First, among the banking reforms promulgated by the Dodd-Frank Act are heightened prudential standards and financial institution resolution arrangements for systemically important financial institutions.[41] Foreign banks may be directly subject to the Dodd-Frank Act's supervision and resolution requirements on the basis of their capitalization, notwithstanding their compliance with standards in their home jurisdictions.[42] Second, with respect to OTC derivatives trading, the possibility of quasi-territorial regulation has arisen most tellingly in the context of the definition of a "U.S. person" under the Dodd-Frank Act. Foreign financial institutions and other foreign market participants may be subject to derivatives rules through quasi-territorial regulation if their U.S.-domiciled operations are considered to be U.S. persons.[43] What makes this

41. Dodd-Frank Act §§ 165-166, 204(a).

42. To cite a prominent example, the Federal Deposit Insurance Corporation (FDIC) has the authority to require a foreign bank with a U.S. presence to submit a resolution plan (commonly referred to as a "living will"), which outlines the liquidation to which it would be subject in the event of a failure. *See* Greenberger, *supra* note 21, at 5 (commenting on the FDIC's proposed rules to require living wills); *see also* Greene & Boehm, *supra* note 26, at 1104-05 (noting the potential conflicts between recovery and resolution planning regulations promulgated pursuant to the Dodd-Frank Act and international regulatory harmonization for multinational financial institutions).

43. The CFTC has defined a "U.S. person" as:

> (i) Any natural person who is a resident of the U.S.; (ii) any corporation, partnership, LLC, business or other trust, association, joint-stock company, fund, or any form of enterprise similar to any of the forgoing that is either: (A) organized or incorporated under the laws of the U.S. or has its principal place of business in the U.S., ("legal entity") or (B) in which the direct or indirect owners thereof are responsible for the liabilities of such entity and one or more of such owners is a U.S. person; (iii) any individual account (discretionary or not) where the beneficial owner is a U.S. person; (iv) any commodity pool, pooled account, or collective investment vehicle (whether or not it is organized or incorporated in the U.S.) of which a majority ownership is held, directly or indirectly, by a U.S. person(s); (v) any commodity pool, pooled account, or collective investment vehicle the operator of which would be required to register as a commodity pool operator under the [Commodity Exchange Act]; (vi) a pension plan for the employees, officers, or principals of a legal entity with its principal place of business inside the United States; and (vii) an estate or trust, the income of which is subject to U.S. income tax, regardless of source.

Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41,214, 41,218 (proposed July 12, 2012). This definition continues to be subject to administrative review and potential modification. *See* Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 43,785 (July 22, 2013) (temporarily delaying implementation of new rules governing swaps under the Dodd-Frank Act).

Conversely, foreign affiliates or agencies of U.S.-based institutions, such as a foreign branch of a U.S. bank, may fall under the definition of U.S. person, and therefore be mode of regulation profoundly powerful is the cross-border diffusion of national rules and standards within vertically-integrated multinational financial institutions.[44] Among the foreign market participants that may be subject to these sorts of compliance costs are international financial institutions and sovereign wealth funds.[45]

EFFECTS-BASED REGULATION. Foreign entities may be subject to regulation for financial activities that have effects in the United States. Effects-based regulation follows the objective, or "protect[ive]," view of territoriality, based on the premise that the U.S. market and investors should be protected from foreign misconduct.[46] Extraterritoriality disputes have arisen prominently with respect to the antifraud provisions of the Securities Exchange Act of 1934 (the Exchange Act).[47] For nearly fifty years, foreign plaintiffs relied on the extraterritorial application of Rule 10b-5 (promulgated pursuant to Section 10b of the Exchange Act) to file so-called "foreign-cubed" securities fraud suits against foreign defendants, alleging fraud in connection with a sale or purchase of securities in foreign markets.[48] In June 2010, the Supreme Court set aside the "effects" test for

subject to the Dodd-Frank Act's derivatives rules. *See* 78 Fed. Reg. at 43,786, 43,789-90 (July 22, 2013) (addressing the centralized clearing of swaps required by the Dodd-Frank Act and the applicability of this rule to foreign branches).

44. The "upstream[ing]" of territorially applied regulatory rules from a local subsidiary to a foreign-domiciled parent company and its international affiliates may be attributable to a manager's desire to reduce compliance and other transaction costs. Brummer, *supra* note 36, at 504-05. Due to differences between the Dodd-Frank Act and non-U.S. regulatory regimes, there is the possibility of foreign entities being subject to overlapping, conflicting, or otherwise incongruent regulations. *See* Christian A. Johnson, *Regulatory Arbitrage, Extraterritorial Jurisdiction and Dodd-Frank: The Implications of US Global OTC Derivative Regulation* (Nov. 10, 2012), at 23, *available at* http://ssrn.com/abstract=2169401 (stating that foreign regulators have noted the possibility of overlapping and conflicts in derivative regulation).

45. *See* Greenberger, *supra* note 21, at 6 (critiquing threats by the European Investment Bank and the European Central Bank not to trade OTC swaps with U.S. banks if they are subject to the Dodd-Frank Act's clearing and collateral posting requirements); Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. REV. 440 (2009) (proposing the repeal of the implicit tax subsidy granted to sovereign wealth funds under a theory of sovereign immunity pursuant to section 892 of the Internal Revenue Code).

46. Turley, *supra* note 1, at 615.

47. The Exchange Act grants jurisdiction to U.S. federal district courts for "conduct occurring outside the United States that has a foreseeable substantial effect within the United States." Exchange Act §27(b)(2) (codified at 15 U.S.C. § 78aa). Section 10b of the Exchange Act requires that a plaintiff prove that a defendant made a material omission or misrepresentation connected with the purchase or sale of a security with scienter, causing economic loss to the plaintiff due to reliance on that omission or misrepresentation. *Id.* at § 10b (codified at 15 U.S.C § 78j(b)).

48. *See* Erez Reuveni, *Extraterritoriality as Standing: A Standing Theory of the Extraterritorial Application of the Securities Laws*, 43 U.C. DAVIS L. REV. 1072, 1083-84

securities fraud actions by establishing a bright-line transactional test that limited the application of Section 10b to purchases or sales made in the United States or involving securities listed on a domestic exchange.[49] Just one month later, Congress responded by including a provision in the Dodd-Frank Act that establishes federal jurisdiction in cases filed by the SEC or the Department of Justice.[50] Effects-based regulation is also expressly set forth in the new derivatives rules of the Dodd-Frank Act, which establish extraterritorial jurisdiction over activities outside the U.S. that "have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations . . . as are necessary . . . to prevent the evasion of any provision of the [Dodd-Frank Act] . . . ."[51]

CONDUCT-BASED REGULATION. Foreign entities may be subject to regulation by U.S. regulators on the basis of transactions with U.S. counterparties (or U.S.-domiciled foreign counterparties) or through U.S. conduits.[52] Foreign financial institutions and other foreign market participants that transact with U.S. counterparties or through U.S. agents, exchanges, bank accounts, or clearing systems may therefore be subject to U.S. regulation even if their activities are undertaken offshore, the U.S. counterparties or conduits act through foreign instrumentalities, and there are no effects on the U.S. market or investors.[53] The broad sweep of this

(2010) (defining "foreign-cubed" lawsuits).

49. Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869 (2010). This case has attracted substantial scholarly attention. *See, e.g.*, Joshua L. Boehm, *Private Securities Fraud Litigation after Morrison v. National Australia Bank: Reconsidering a Reliance-Based Approach to Extraterritoriality*, 53 HARV. INT'L L.J. 249 (2012) (discussing the narrowed scope of Rule 10b-5 under the new test); Marco Ventoruzzo, *Like Moths to a Flame? International Securities Litigation After Morrison: Correcting the Supreme Court's "Transactional Test"*, 52 VA. J. INT'L L. 405 (2012) (noting the shortcomings of the new test and proposing an alternate effects test).

50. Section 929(P) of the Dodd-Frank Act provides, in relevant part:

> (c) Extraterritorial Jurisdiction.—The district courts of the United States and the United States courts of any Territory shall have jurisdiction . . . alleging a violation of [the antifraud provisions of this title] involving—"(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the violation is committed by a foreign adviser and involves only foreign investors; or "(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States."

Dodd-Frank Act § 929 (P).

51. Dodd-Frank Act § 722 (for swaps) and § 772(c) (for security-based swaps).

52. *See* Johnson, *supra* note 44, at 2.

53. An illuminating example is found in the regulation of derivatives under the Dodd-Frank Act. CFTC rules require a U.S. person to comply with transaction-level rules (*i.e.*, requirements that apply to each swap transaction, such as clearing, margin, and real-time

extraterritorial approach is evident in the "conduct" test that was the counterpart to the "effects" test in securities antifraud actions under the Exchange Act.[54] The conduct test established federal subject matter jurisdiction if foreign investors could demonstrate harm as a result of conduct emanating from the United States. In essence, this test looks at the situs and the materiality of the conduct in question, regardless of the location of the parties or the markets where the transaction took place.[55] This approach, like the effects test, has been criticized for its inconsistent and unpredictable application, weighing against the tremendous discretion that it gives judges to remedy alleged harms committed beyond the territorial reach of U.S. laws.[56] As with the effects test, the Dodd-Frank Act expressly provides for extraterritorial jurisdiction on the basis of the conduct test.[57]

The efficacy of any of these kinds of extraterritorial regulatory authority is contingent on highly concentrated state power. That is, the ability of a country to project its regulatory rules on foreign entities and offshore economic activity depends on its status as an economic hegemon, such as the United States, whose own internal market is powerful enough

---

reporting) in respect of any swap, regardless of where the transaction is actually conducted. Since the definition of U.S. person covers foreign banks whose principal place of business is in the United States, a foreign-based bank with significant operations in the United States may fall under the definition of U.S. person and thereby be required to comply with the Dodd-Frank Act for all of its swaps activities worldwide—in spite of any overlapping or conflicting regulatory requirements in their home countries. *See* Final Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 858, 863-64 (Jan. 7, 2013) (stating that the CFTC will not treat entities incorporated or organized outside the United States and with a principal place of business in the United States as a "U.S. person" until April 1, 2013).

54. The Exchange Act provides jurisdiction to U.S. federal district courts for "conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors." Exchange Act §27(b)(1) (codified at 15 U.S.C. § 78aa).

55. *See* Genevieve Beyea, *Morrison v. National Australia Bank and the Future of Extraterritorial Application of the U.S. Securities Laws*, 72 OHIO ST. L.J. 537, 543 (2011) (describing the conduct test and the challenges in applying it).

56. *See* Alex Reed, *But I'm an American! A Text-Based Rationale for Dismissing F-Squared Securities Fraud Claims After Morrison v. National Australia Bank*, 14 U. PA. J. BUS. L. 515, 517-18 (2012) (discussing the various applications of the effects test before *Morrison*).

57. *See* Dodd-Frank Act § 929P(b)(1) (amending the Securities Act to adopt the conduct test). Commentators have noted the incongruence between the apparent Congressional intent to rebut the presumption against extraterritoriality in *Morrison* and the Supreme Court's rejection of the effects and conducts tests on the basis of the substantive scope of Section 10(b) and not due to a lack of subject matter jurisdiction. *See* Richard W. Painter, *The Dodd-Frank Extraterritorial Jurisdiction Provision: Was It Effective, Needed or Sufficient?*, 1 HARV. BUS. L. REV. 195, 199-205 (2011).

either to deter or mitigate the negative effects of retaliation by foreign regulators.[58] However, the relative decline in the international financial market dominance of the United States, along with the proliferation of new sources of financial capital and the emergence of competing regulators in new markets, may materially hinder the United States' ability to regulate in this manner.[59] Financial globalization may impose a double-bind on U.S. financial regulators by fostering new forms of cross-border financial activities in unprecedented volume, while simultaneously hindering their ability to manage and supervise the sources of these activities.

The extraterritorial application of U.S. law is circumscribed, both expressly and implicitly, by canons of construction and principles of American constitutional law.[60] First and foremost is the presumption against extraterritoriality, which posits that a law should be interpreted to apply only within the territorial jurisdiction of the United States absent express congressional intent of its extraterritorial reach.[61] Another canon of construction is the *Charming Betsy* canon, derived from Chief Justice John Marshall's statement that "an act of Congress ought never to be construed to violate the law of nations if any other possible construction remains."[62] These canons reflect the fundamental importance of the doctrine of comity as a principle of national decisionmaking. Comity is defined as "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation."[63] Judicial pronouncements rejecting the extraterritorial reach of domestic law are often clothed in the language of comity through the application of the presumption against extraterritoriality and the *Charming Betsy* canon, which establish a rebuttable presumption against extraterritoriality that may only be overcome by clear, explicit, and irrefutable evidence of legislative intent to the contrary. Comity, when applied in this manner by a court, can serve as a flexible tool of judicially-imposed abnegation of domestic statutory

58. *See* BRUMMER, *supra* note 28, at 40-43 (describing the "political economy" problem of extraterritorial regulation).

59. *Id*. at 45-49 (citing the factors for the weakening of American financial dominance and the effects on extraterritorial regulatory export by the United States).

60. *See* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 402-03 (1987) (detailing the current status of the jurisdiction to prescribe under U.S. law). Although there is no express prohibition in the Constitution on the promulgation of extraterritorial legislation by Congress, the specific congressional powers in the Constitution pursuant to which Congress may legislate extraterritorially include potential limits on this authority. *See* Colangelo, *supra* note 31, at 136-58 (analyzing the Offence Clause, the Foreign Commerce Clause, the Treaty Power, and the Foreign Affairs Power).

61. *See* EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991).

62. Murray v. Schooner Charming Betsy, 6 U.S. 64, 118 (1804).

63. Hilton v. Guyot, 159 U.S. 113, 143 (1895).

authority.[64] Existing doctrines and practices, however, are too inchoate and narrowly applied to provide a consistent, predictable basis for addressing the tensions between extraterritorial jurisdiction and national sovereignty in the context of regulatory authority.[65]

2. Transnational Governance: Extraterritorial Regulation by Other Means

The limitations of extraterritorial regulation reflect the evolving, multilayered environment of international finance. Extraterritoriality is but one component of the set of rules, resources, and institutions that manage international financial and monetary affairs—the so-called international financial architecture. The political and legal constraints faced by governmental authorities seeking to regulate extraterritorially, coupled with the limits of treaty-based regimes, have led countries in the past several decades to explore new forms of global financial regulation. The global, broadly inter-connected nature of market participants and their activities reinforces the need for governments to address obstacles to regulatory coordination, particularly given the newfound emphasis on identifying and managing systemic risk following the global financial crisis.

Regulatory authority is increasingly exercised through multiple, overlapping regulatory frameworks that feature a wide constellation of stakeholders and cross several distinct jurisdictional boundaries.[66] To facilitate international coordination and cooperation in the absence of a global financial regulator, new models of transnational economic regulation have emerged, consisting of a latticework of predominantly non-binding rules, standards, and best practices developed by national regulatory agencies, private standard-setting bodies, international financial institutions, and various non-state actors.[67] These new forms of global governance eschew state-centric regulation and mandatory rules for rulemaking based on consultation, soft law norms, and the direct and/or

64. *See* Michael D. Ramsey, *Escaping "International Comity"*, 83 IOWA L. REV. 893, 906-38 (1998) (analyzing the circumstances in which courts may apply comity).

65. *See infra* Part III.A.

66. *See* Rolf H. Weber, *Multilayered Governance in International Financial Regulation and Supervision*, 13 J. INT'L ECON. L. 683, 685-86 (2010) (describing the limited scope and enforcement powers of traditional international law instruments and the fragmentation of global financial regulation).

67. *See* Anu Piiola, *Assessing Theories of Global Governance: A Case Study of International Antitrust Regulation*, 39 STAN. J. INT'L. L. 207, 208-09 (2003) (defining transgovernmental and transnational models of global governance as well as traditional intergovernmental governance and concluding that none of them alone is sufficient or desirable).

indirect participation of non-state actors.[68]

One particular model of global governance, transgovernmental regulatory networks, involves regulation through self-interested domestic regulators working in close coordination across national borders, instead of being confined within the administrative rulemaking and strategic decision-making processes of individual states.[69] The regulation of various areas of global finance has been a productive area for these kinds of networks. The Financial Stability Board, established by the G20 in 2009 to coordinate financial policies globally, includes the central banks and finance ministries from most G20 member countries and a number of international financial institutions and standard-setting bodies.[70] In the banking sector, the Basel Committee on Banking Supervision, which formulated the 1988 Basel Accord on capital adequacy (known as Basel I), arguably constitutes the apex of network-based global lawmaking, and has continued its work in the formulation of new capital adequacy standards under Basel I's successors, Basel II and Basel III.[71] In regards to securities regulation, the International Organization of Securities Commissions (IOSCO) and various bilateral cooperative agreements have played an important role in global standard-setting.[72] With respect to the regulation of the global OTC derivatives market, the Dodd-Frank Act expressly mandates that the SEC, CFTC, and prudential regulators (such as the Federal Reserve) engage in consultation and coordination with their foreign regulatory counterparts.[73] Similarly, transnational private networks have worked alongside public transnational institutions to reduce systemic risk through the implementation of mandatory central counterparty clearing of swaps.[74]

---

68. *See* Kenneth W. Abbott & Duncan Snidal, *Strengthening International Regulation through Transnational New Governance: Overcoming the Orchestration Deficit*, 42 VAND. J. TRANSNAT'L L. 501, 541-45 (2009) (describing decentralized transnational governance schemes).

69. *See* Kal Raustiala, *The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law*, 43 VA. J. INT'L L. 1, 5 (2002); David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEX. INT'L L.J. 281, 312-25 (1998). *See also* Abbott & Snidal, *supra* note 68, at 505 (distinguishing transgovernmental regulatory networks from other transnational governance schemes run by private actors).

70. *See* Greene & Boehm, *supra* note 26, at 1090-91.

71. *See* Pierre-Hugues Verdier, *Transnational Regulatory Networks and Their Limits*, 34 YALE J. INT'L L. 113, 132-43 (2009).

72. *See* Raustiala, *supra* note 69, at 28-35; Zaring, *supra* note 69, at 292-97.

73. *See* Dodd-Frank Act § 752.

74. *See* Anupam Chander & Randall Costa, *Clearing Credit Default Swaps: A Case Study in Global Legal Convergence*, 10 CHI. J. INT'L L. 639, 678-80 (2010) (detailing the role of transnational networks in causing regulatory convergence). Swaps, a type of derivative instrument, consist of customized legal contracts based on standardized industry models that are privately negotiated and settled by counterparties to provide each other with

Viewed in their best light, these networks represent the zenith of the "disaggregated state": the constitutive components of national governments collectively acting as a world government, in function but not form.[75] However, the transformational effects of networks on the international economic system are unsettled.[76] Further, their limitations reveal the salience of problems in global financial regulation that are shared by extraterritorial regulation. Indeed, these global governance mechanisms—rather than supplanting domestic regulation—instead complement and augment extraterritorial regulatory authority.[77] The coordination rationale for transgovernmental regulatory networks—specifically, the desire of domestic regulators to find quicker, more efficient ways to cooperate across borders—hints at the extent to which domestic politics might dominate the regulatory process. Far from occupying a global technocratic space removed from the vagaries of domestic lawmaking, transgovernmental regulatory networks may shape and perpetuate the preferences of domestic interests and the underlying state power of their participants.[78] Notwithstanding the shift away from traditional modes of government-dictated regulatory authority based on command-and-control, these new forms of global governance complement and augment domestic extraterritorial power rather than supplanting or compromising it.[79] Governments continue to assert their sovereign authority over non-state actors.[80] Rather than being modulated by informal

a series of cash flows. In contrast to futures and options, swaps are not based on the physical exchange of underlying assets. They are used to hedge risk, lower funding costs, and for speculative purposes, among other reasons. *See* SCOTT & GELPERN, *supra* note 9, at 959-64.

75. *See* ANNE-MARIE SLAUGHTER, A NEW WORLD ORDER 36-64 (2004) (discussing the role of transgovernmental networks of regulators as an integral component of a "new world order").

76. *See* Verdier, *supra* note 71, at 161-70; Sungjoon Cho & Claire R. Kelly, *Promises and Perils of New Global Governance: A Case of the G20*, 12 CHI. J. INT'L L. 491, 548-53 (2012) (addressing doubts about the effectiveness of the G20 coordinating functions in the wake of the global financial crisis).

77. *See* Daniel W. Drezner, *Globalization and Policy Convergence*, 3 INT'L STUD. REV. 53, 76-77 (2001) (noting that changes in the international economic system induced by globalization have affected the bargaining *modus operandi* of state regulatory power but have not inexorably diminished it).

78. *See* Verdier, *supra* note 71, at 161-62; Brummer, *supra* note 27, at 642; Cho & Kelly, *supra* note 76, at 555-56.

79. *See* Robert F. Weber, *New Governance, Financial Regulation, and Challenges to Legitimacy: The Example of the Internal Models Approach to Capital Adequacy Regulation*, 62 ADMIN. L. REV. 783, 839-41 (2010) (evaluating the use of risk models in regulatory regimes).

80. *See* DREZNER, *supra* note 22, at 19-22 (describing and critiquing global civil society theories of globalization).

consultative processes, the state remains the cornerstone of global financial regulation, and the regulatory reach of powerful states is augmented as a result of their ability to encourage, persuade, or compel their foreign regulatory counterparts to adopt their preferred regulatory models.[81]

II. THE FINANCIAL ACTIVITIES AND LEGAL TREATMENT OF STATE-OWNED FINANCIAL ENTITIES

The expanding scope of global financial regulation reflects the collective desire to respond to the risks of financial globalization. The rationale for regulation rests on the balancing of the public interest with the private interests of market participants. This dynamic is complicated in the case of state-owned financial entities, whose legal character reflects their uniquely public missions. Most importantly, their immunities and privileges from jurisdiction have been long enshrined under international law. The normative and operational implications of extraterritorial regulation are underscored by the unique role of the state as a market participant.

The following discussion describes this unique class of entities and their growing engagement in the financial markets as well as their increasingly important role as global financial regulators. This analysis may also provide insights applicable to state-owned banks and other state-owned enterprises with non-public missions, which are not directly addressed in this Article. It provides an overview of the distinct, yet related doctrines of sovereign immunity and intergovernmental immunity. An in-depth examination of the experience of international financial institutions in respect of the Dodd-Frank Act's derivatives rules suggests how international privileges and immunities may limit, preclude, or condition the regulation of the financial activities of IFIs and other state-owned financial entities.

A. The Structure and Activities of State-Owned Financial Entities in Global Financial Markets

State-owned financial entities participate in global financial markets in a variety of ways. They engage in borrowing and lending operations with private banks and other financial institutions. They issue bonds in global securities markets. They use swaps and other derivatives instruments to hedge risk. They invest in debt and equity through investment funds.

81. *See* Raustiala, *supra* note 69, at 56-61 (describing network-driven regulatory convergence).

The major classes of state-owned financial entities with a substantial presence in global financial markets include:

CENTRAL BANKS. Central banks are governmental institutions with wide-ranging monetary and regulatory responsibilities, among which include setting interest rates, controlling the country's money supply (open market operations), managing foreign exchange reserves, supervising the banking system, and serving as the government's banker.[82] In these capacities, central banks lend and borrow from private banks to determine market interest rates, and also make available loans to distressed private financial institutions as a lender of last resort.[83] Central banks buy and sell debt securities and use foreign currency swaps to conduct open market operations and manage their foreign exchange reserves.[84] Many central banks issue their own debt securities to facilitate exchange rate and liquidity policy objectives.[85] They are generally owned by a central government and organized as a separate legal entity.[86]

INTERNATIONAL FINANCIAL INSTITUTIONS (IFIS). IFIs are financial institutions established and owned by multiple governments. The most prominent and influential IFIs are the Bretton Woods institutions established after World War II: the IMF and the World Bank.[87] Alongside

82. The breadth of central bank operations and policies is beyond the scope of this Article. For further discussion of central bank policies, see HANDBOOK OF CENTRAL BANKING, FINANCIAL REGULATION AND SUPERVISION (Sylvester Eijffinger & Donato Masciandaro eds., 2011).

83. *See* SCOTT & GELPERN, *supra* note 9, at 43-46, 262-63 (describing the Federal Reserve Bank's use of its discount window); *see also* Note, *Too Sovereign to be Sued: Immunity of Central Banks in Times of Financial Crisis*, 124 HARV. L. REV. 550, 565-66 (2010) (describing central banks' liquidity support during the global financial crisis) [hereinafter HLR Note].

84. *See* Catharina J. Hooyman, *The Use of Foreign Exchange Swaps by Central Banks: A Survey* (IMF Working Paper No. 93/64, Aug. 1993), *available at* http://www.imf.org/external/pubs/cat/longres.aspx?sk=1139 (discussing the use and problems with foreign exchange swaps).

85. *See* Andrew Filardo, Madhusudan Mohanty & Ramon Moreno, *Central Bank and Government Debt Management: Issues for Monetary Policy*, *in* FISCAL POLICY, PUBLIC DEBT AND MONETARY POLICY IN EMERGING MARKET ECONOMIES 51, 54-55, 66-68 (BIS Papers No. 67, Oct. 2012), *available at* http://www.bis.org/publ/bppdf/bispap67d_rh.pdf (looking at the growth of the government debt market). The Federal Reserve Bank does not issue its own bonds. *See* Robert Cyran & Dwight Cass, *Reducing Debt, But Also Prospects*, N.Y. TIMES, Dec. 11, 2008, at B2 (criticizing the prospect of the Federal Reserve Bank issuing its own bonds).

86. *See* Paul L. Lee, *Central Banks and Sovereign Immunity*, 41 COLUM. J. TRANSNAT'L L. 327, 350-51 (2003).

87. The World Bank Group consists of five institutions, most of which are devoted to economic development: the International Bank for Reconstruction and Development

the World Bank are numerous other multilateral development banks that provide financing and technical assistance for development-related purposes in specific regions, most notably: the African Development Bank (AfDB), the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), and the Inter-American Development Bank (IDB). IFIs are international organizations, established pursuant to international treaties and governed by their member states.[88] These institutions issue debt securities to institutional and retail investors in capital markets throughout the world to fund their operations.[89] They use derivatives to hedge market risks in lending, borrowing, equity management, and investment operations.[90]

SOVEREIGN WEALTH FUNDS (SWFS). Sovereign wealth funds are investment vehicles that are owned by governments, funded by foreign exchange assets, and managed separately from official reserves.[91] These funds have been subject to growing scrutiny in recent years due to their shift from conservative debt instruments to comparatively higher-yielding equities—most notably, acquisitions of partial ownership stakes in private financial entities such as Blackstone, Morgan Stanley, and UBS.[92]

(IBRD); the International Development Association (IDA); the International Finance Corporation (IFC); the Multilateral Investment Guarantee Agency (MIGA); and the International Centre for Settlement of Investment Disputes (ICSID).

88. *See* Articles of Agreement of the International Monetary Fund, July 22, 1944, 2 U.N.T.S. 39 [hereinafter IMF Articles of Agreement]; International Bank of Reconstruction and Development Articles of Agreement, Dec. 27, 1945, 2 U.N.T.S. 13 [hereinafter IBRD Articles of Agreement]; Agreement Establishing the African Development Bank, Aug. 4, 1963, 510 U.N.T.S. 3 [hereinafter AfDB Agreement]; Agreement Establishing the Asian Development Bank, Aug. 22, 1966, 571 U.N.T.S. 123 [hereinafter ADB Agreement]; Agreement Establishing the European Bank for Reconstruction and Development, Mar. 28, 1991, 29 I.L.M. 1083 [hereinafter EBRD Agreement]; Agreement Establishing the Inter-American Development Bank, Dec. 30, 1959, 389 U.N.T.S. 69 [hereinafter IDB Charter].

89. IBRD alone borrows approximately U.S. $30 billion a year through bond issuances. *See Everything you always wanted to know about the World Bank*, THE WORLD BANK, http://treasury.worldbank.org/cmd/pdf/WorldBankFacts.pdf (last visited May 15, 2014).

90. *See, e.g.*, IBRD, *Management's Discussion & Analysis and Financial Statements*, at 7, 81-88 (June 30, 2012), *available at* http://treasury.worldbank.org/cmd/pdf/IBRD_MDA_and_Financial_Statements_June_2012.pdf (describing IBRD's use of swaps to hedge interest rate risk and foreign exchange risk). IBRD also offers derivatives intermediation services to its developing country borrowers. *See id*. at 14, 81 (describing the IBRD's uses of derivative instruments).

91. Paul Rose, *Sovereigns as Shareholders*, 87 N.C. L. REV. 102, 103 (2008). Among the largest and most active SWFs are Norway's Government Pension Fund – Global, the Abu Dhabi Investment Authority, the China Investment Corporation, and Temasek Holdings of Singapore.

92. *See* Richard A. Epstein & Amanda M. Rose, *The Regulation of Sovereign Wealth*

Regulatory concerns specific to SWFs have focused on the specter of their political influence on investment decisions.[93]

Regulation of these state-owned financial entities by foreign and international regulators addresses a number of policy considerations. State-owned financial entities are sometimes subject to the same requirements as their private sector counterparts, with no expressly different treatment due to their sovereign or supranational status.[94] In other instances, they are subject to special requirements, such as the disclosure rules of the Securities Act of 1933 (the Securities Act) for foreign governmental issuers.[95] Alternatively, they are exempted from certain regulatory requirements due to their sovereign or supranational status.[96] State-owned financial entities may be subject to special regulation if they engage in certain types of financial activities or fail to meet certain industry-determined standards.[97] The application of international privileges and

Funds: The Virtues of Going Slow, 76 U. CHI. L. REV. 111, 116 (2009).

93. *See* Lawrence Summers, *Funds That Shake Capitalist Logic*, FIN. TIMES, July 29, 2007 (raising concerns about SWFs' pursuit of objectives other than maximizing risk-adjusted returns, such as extracting technology from companies or exerting political influence over host country governments).

94. *See* Epstein & Rose, *supra* note 92, at 117-18 (noting that SWFs are subject to the Exchange Act's disclosure requirements under Section 13(d) and anti-fraud provisions of federal securities, antitrust, and state corporate laws).

95. *See* Securities Act § 7 Information Required on Registration Statement (codified at 15 U.S.C. § 77g); *see also* Edward F. Greene & Ronald Adee, *The Securities of Foreign Governments, Political Subdivisions and Multinational Organizations*, 10 N.C. J. INT'L L. & COM. REG. 1, 6-16 (1985) (detailing disclosure requirements of foreign governments that issue securities in the U.S.).

96. Numerous examples abound in various areas of financial regulation. For example, the World Bank and regional multilateral development banks are exempt from the registration requirements of the Securities Act and the disclosure requirements of the Exchange Act. Instead, each institution is required only to file its annual report, quarterly financial reports, and advance reports of any distributions in the United States. *See* 22 U.S.C. § 286k-1 (IBRD); 22 U.S.C. § 290i-9 (AfDB); 22 U.S.C. § 285h (ADB); 22 U.S.C. § 290l-7 (EBRD); 22 U.S.C. § 283h (IDB); *see also* Greene & Adee, *supra* note 95, at 24-28 (discussing the historical development of securities disclosure requirements). Another example is Basel I's treatment of sovereign debt. Under Basel I capital adequacy rules, debt issued by the Federal Reserve Bank and other OECD-member central banks were granted zero risk weighting, thereby granting preferential treatment to such sovereigns vis-à-vis other securities issuers. *See* SCOTT & GELPERN, *supra* note 9, at 566 (summarizing credit risk under Basel I).

97. The Santiago Principles, a voluntary code of conduct created by certain governments that own SWFs, establishes an equivalency standard for SWFs, stipulating that host countries shall "not subject SWF[s] to any requirement, obligation, restriction, or regulatory action exceeding that to which other investors in similar circumstances may be subject" so long as SWFs operate "in compliance with all applicable regulatory and disclosure requirements." International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds: Generally Accepted Principles and Practices "Santiago Principles" (Oct. 2008), GAPP 15 Principle, Explanation and Commentary, *available at*

immunities may result in a complete or partial exemption from regulation of a given class of state-owned entity or certain conditions on their regulation.[98]

Within the panorama of financial globalization and global financial regulation, the activities of state-owned financial entities as market participants are important in two respects. First, the growth and proliferation of state-owned financial entities means that they will continue to transact with and, in certain contexts, compete against their private sector counterparts.[99] Second, the regulatory footprint of some of these very same market participants has continued to evolve and expand. Central banks, within their own respective jurisdictions and in coordination with each other, engage in macroprudential supervision.[100] Another important element of global financial regulation is the role of IFIs. The regulatory authority of the IMF, the World Bank, and other IFIs has been traditionally restricted by the limited legal scope of their missions.[101] Although their capacity to regulate through conditionality (*i.e.*, by making financial and technical assistance to borrowers conditional on the implementation of domestic regulatory standards or policies) is limited by demand for their

http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf. *See also* Larry Catá Backer, *Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investments*, 41 GEO. J. INT'L L. 425, 448 (2010); Joseph J. Norton, *The "Santiago Principles" and the International Forum of Sovereign Wealth Funds: Evolving Components of the New Bretton Woods II Post-Global Financial Crisis Architecture and Another Example of Ad Hoc Global Administrative Networking and Related "Soft" Rulemaking?*, 29 ANN. REV. BANKING & FIN. L. 465, 512-18 (2010) (describing the scope of the Santiago Principles).

98. *See infra* Part II.C.

99. IFIs have established investment companies that manage funds on behalf of third party clients. One notable example is the IFC Asset Management Company (AMC), a wholly-owned subsidiary of the World Bank Group's International Finance Corporation, which invests public and private funds in IFC co-financed projects. As of March 31, 2012, AMC had approximately U.S. $4.2 billion in assets under management. *See* IFC Asset Management Company, Issue Brief, http://www1.ifc.org/wps/wcm/connect/3e284300486a6c72bc9afff995bd23db/SM12_IFCIssueBrief_AMC.pdf?MOD=AJPERES (last visited May 15, 2014).

100. The Dodd-Frank Act requires the Financial Stability Oversight Council, the Board of Governors of the Federal Reserve System, and the Secretary of the Treasury to consult with foreign regulatory counterparts and international organizations in respect of matters relating to systemic risk and prudential regulation. *See* Dodd-Frank Act § 175(b) and (c), 12 U.S.C. § 5373 (2012); *see also* Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, Speech at the 47th Annual Conference on Bank Structure and Competition: Implementing a Macroprudential Approach to Supervision and Regulation (May 5, 2011), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20110505a.pdf (discussing macroprudential policy in the United States).

101. *See* Pan, *supra* note 15, at 251; *see also* Abbott & Snidal, *supra* note 68, at 533-37 (noting the weak governance powers of traditional intergovernmental organizations).

resources, the significant uptick in their lending activities in the aftermath of the global financial crisis refutes concerns of their obsolescence.[102] The surveillance and monitoring responsibilities of the World Bank and the IMF, both of macroeconomic stability generally as well as financial codes and standards specifically, are unique in the international system.[103] The role of IFIs to promote best practices through technical assistance and economic analysis, though not formalized as a regulatory power *per se*, underscores the broad-based roles of these institutions in structuring financial markets.[104]

B. International Privileges and Immunities under International Law

State-owned financial entities may seek exemption from extraterritorial regulation on the basis of international privileges and immunities, a diverse set of principles under international law for the benefit of states and international organizations. Their diverse rationales and applications, coupled with uncertainty regarding their relevance to the regulation of financial activities, necessitate a closer examination.

1. The Doctrine of Sovereign Immunity

The doctrine of sovereign immunity permits a state to claim freedom from the jurisdiction of a foreign state.[105] Sovereign immunity developed

---

102. *See* BRUMMER, *supra* note 28, at 147-50. *But see* David Zaring, *International Institutional Performance in Crisis*, 10 CHI. J. INT'L L. 475, 490-93 (2010) (arguing that the IMF has a narrow role in the international financial architecture solely relevant to developing countries).

103. *See* Brummer, *supra* note 8, at 281-82 (discussing the Financial Sector Assessment Program and financial sector assessments included in Reports on Observance and Codes issued by the IMF and the World Bank). *But see* Pan, *supra* note 15, at 252 n.26 (noting the lack of authority in the IMF Articles of Agreement to directly monitor private firms).

104. The World Bank's Financial and Private Sector Development Vice Presidency, which includes programs devoted to financial systems, financial infrastructure, financial market integrity, and corporate governance, is one example.

105. In this context, the doctrine of sovereign immunity has developed to address its application at distinct stages of the judicial process: (i) foreign state immunity from the jurisdiction of the courts of another state to adjudicate a claim against it (immunity from jurisdiction); and (ii) the exemption of a foreign state from enforcement of an adverse judgment through attachment and execution of its state property (immunity from attachment and execution). Akehurst, *supra* note 33, at 118. It may be contrasted to the invocation of international privileges and immunities in the context of exercises of regulatory authority—*i.e.*, regulatory immunity.

The Act of State doctrine is the most notable example of a doctrine related to, but doctrinally distinct from, sovereign immunity. Under U.S. law, the Act of State doctrine provides that U.S. courts will not judge the validity of official acts of a foreign government from the nation-state system, based on the sanctity of national sovereignty and the principle of non-interference by any one state in the internal affairs of any other. Traditionally, the practice and policies of the United States were based on the theory of absolute immunity, which granted foreign states immunity for all their activities.[106] Marked by the Tate Letter in 1952, the United States adopted the "restrictive" approach to immunity, which distinguishes between a foreign state's governmental acts (*jure imperii*) and its private acts (*jure gestionis*), the latter of which are not entitled to sovereign immunity.[107]

The restrictive approach was codified in U.S. law by the Foreign Sovereign Immunities Act (FSIA) of 1976, which vests responsibility for immunity determinations by the U.S. government with the federal judiciary.[108] The FSIA establishes a general rule of sovereign immunity with certain specific, statutorily-defined exceptions.[109] A key consideration with respect to sovereign immunity revolves around the definition of a foreign state. The FSIA expressly includes in its definition of foreign state a political subdivision of a foreign state or an agency or instrumentality of a foreign state.[110] Government ministries and central banks are afforded the

carried out in its own territory. *See* Underhill v. Hernandez, 168 U.S. 250, 252 (1897). Much like the doctrine of sovereign immunity, the Act of State doctrine has been applied in an *ad hoc* manner in respect of the enforcement of foreign sovereign contracts, leading to unpredictability in international commercial transactions with foreign government counterparties. *See* Michael D. Ramsey, *Acts of State and Foreign Sovereign Obligations*, 39 HARV. INT'L. L.J. 1, 2-4, 46-51 (1998) (discussing the application of the Act of State doctrine).

106. *See* Argentine Republic v. Amerada Hess Shipping Corp., 488 U.S. 428, 434 n.1 (1989).

107. *See* Letter of Acting Legal Adviser to the Secretary of State, Jack B. Tate, to Department of Justice (May 19, 1952) *reprinted in* 26 Dep't. State Bull. 984 (1952); *see also* Alfred Dunhill of London v. Republic of Cuba, 425 U.S. 682, 711–715 (1976) (quoting the same).

108. Pub. L. No. 94-583, 90 Stat. 2891 (1976) (codified in various sections of Title 28 of the U.S. Code) [hereinafter FSIA]. The FSIA governs both immunity from jurisdiction and immunity from attachment and execution. The following discussion addresses the rules that apply to the former due to its nexus with the right of a foreign state to assert regulatory immunity.

Multilateral initiatives have had modest success and limited effects on state practice. The European Convention on State Immunity entered into force in 1976, and includes eight signatory parties. *See* European Convention on State Immunity, May 16, 1972, 11 I.L.M. 470 (1972). The United Nations Convention on Jurisdictional Immunities of States has not yet been ratified by a sufficient number of states to enter into force. *See* United Nations Convention on Jurisdictional Immunities of States and Their Property, G.A. Res. 59/38 U.N. Doc. A/RES/59/38 (Dec. 2, 2004).

109. The FSIA provides that "a foreign state shall be immune from the jurisdiction of the courts of the United States . . . except as provided in sections 1605 to 1607 of this chapter." 28 U.S.C. § 1604 (2010).

110. *Id*. at § 1603(a).

protections of the FSIA, as well as many other state-owned financial entities.[111] Nonetheless, there is uncertainty regarding the extent to which a separately-managed state-owned entity (such as a SWF) would be treated differently from an entity with a discrete pool of assets but without legal personality separate from the state.[112]

The FSIA enumerates nine categorical exceptions to sovereign immunity—most notably, the waiver exception and the commercial activity exception.[113] The waiver exception concerns the waiver by a foreign state of its sovereign immunity, either explicitly or by implication.[114] Explicit waivers constitute a contractual agreement by a foreign state to forego the default rule of immunity in the context of negotiated financial transactions.[115] The commercial activity exception, in contrast, strips the protections of sovereign immunity whenever a foreign state engages in a course of conduct, a particular transaction, or an act that is commercial in nature, regardless of its purpose.[116] Under this reasoning, the commercial activity exception applies to any type of conduct that a private party could

111. The FSIA broadly defines "agency or instrumentality of a foreign state" to cover any entity:

> (1) which is a separate legal person, corporate or otherwise, and
>
> (2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and
>
> (3) which is neither a citizen of a State of the United States . . . nor created under the laws of any third country.

Id. at § 1603(a) and (b).

However, indirect state ownership of a firm, such as through a holding company, does not qualify. *See generally* Dole Food Co. v. Patrickson, 538 U.S. 468 (2003) (examining if and how sovereign immunity applies to firms owned by a foreign state).

112. *See* David Gaukrodger, Foreign State Immunity and Foreign Government Controlled Investors (OECD Working Papers on International Investment 2010/2, 2010), at 14-18, *available at* http://www.oecd.org/corporate/mne/45036449.pdf; HLR Note, *supra* note 83, at 558-63 (describing the efforts of litigants seeking attachment of central bank assets based on the argument that central banks are the corporate "alter ego" of their state parents).

113. *See* 28 U.S.C. § 1605 (2010) (setting forth the FSIA's specific exceptions to immunity from jurisdiction). The other exceptions to sovereign immunity specified in the FSIA are based on: expropriation; property in the United States; tort injury occurring in the United States; arbitration; torture, extrajudicial killing, sabotage, or kidnapping; enforcement of a maritime lien; and foreclosure of a maritime mortgage.

114. *Id*. at § 1605(a)(1).

115. *See* Lee, *supra* note 86, at 338-39.

116. *See* 28 U.S.C. § 1603(d) (2010) (defining commercial activity); *see also* Republic of Argentina v. Weltover, 504 U.S. 607, 617 (1992) (applying the commercial activity exception to the rescheduling of bonds issued by the Government of Argentina and determining that it was "irrelevant *why* Argentina participated in the bond market in the manner of a private actor; it matters only that it did so").

similarly conduct.[117] The commercial activity exception provides jurisdiction based upon a nexus with the United States established by: (i) "a commercial activity carried on in the United States"; (ii) "an act performed in the United States in connection with a commercial activity" elsewhere; or (iii) "an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere" if the "act causes a direct effect in the United States."[118]

2. The Doctrine of Intergovernmental Immunity

The privileges and immunities of international organizations, or intergovernmental immunity, share the underlying principles of sovereign immunity. Intergovernmental immunity is expressly incorporated into the international treaties by which IFIs are governed.[119] The application of intergovernmental immunity reflects its distinct doctrinal foundations and purposes. The creation of international organizations in the mid-nineteenth century spurred their member states to endow them with diplomatic privileges and immunities.[120] In contrast to sovereign immunity, the evolution of intergovernmental immunity in the twentieth century did not lead to the adoption of restrictive immunity based on the distinction between governmental and private acts. Instead, the basis for intergovernmental immunity is functional necessity, or the idea "that

117. *See Weltover*, 504 U.S. at 614.

118. 28 U.S.C. § 1605(a)(2) (2010).

119. The IBRD Articles of Agreement is generally indicative:

> Actions may be brought against the Bank only in a court of competent jurisdiction in the territories of a member in which the Bank has an office, has appointed an agent for the purpose of accepting service or notice of process, or has issued or guaranteed securities. The property and assets of the Bank shall, wheresoever located and by whomsoever held, be immune from all forms of seizure, attachment or execution before the delivery of final judgment against the Bank.

IBRD Articles of Agreement, *supra* note 88, at art. VII(3). The parallel provisions of the agreements of IDA, IFC, and most of the regional multilateral development banks include substantively identical language. *See* International Development Association Articles of Agreement, Jan. 24, 1960, 439 U.N.T.S. 249, art. VII(3); International Finance Corporation Articles of Agreement, May 25, 1955, 264 U.N.T.S. 118, art. VI(3); AfDB Agreement, art. 52; EBRD Agreement, arts. 44 and 46; IDB Charter, art. XI(3).

In contrast, the IMF Articles of Agreement expressly provides for absolute immunity without qualification, except upon an express waiver by the IMF itself. *See* IMF Articles of Agreement, art. IX(3) (explaining how the IMF has full immunity from legal proceedings unless waived).

120. *See* Charles H. Brower, *International Immunities: Some Dissident Views on the Role of Municipal Courts*, 41 VA. J. INT'L L. 1, 9-11 (2000) (explaining the development of immunities for international organizations during the 1800s and early 1900s).

international organizations are entitled to such immunities as will enable them to exercise their functions in the fulfillment of their purposes."[121] This doctrine, initially established in the United Nations Charter, is considered a customary rule of international law, applicable to both member states and non-member states.[122] It is generally reflected in IFIs' constitutive agreements, which do not include commercial activity exceptions.[123]

The International Organization Immunity Act of 1945 (IOIA) is the principal statutory basis for intergovernmental immunity under U.S. law.[124] The text of the IOIA appears to support an expansive view of intergovernmental immunity that more closely resembles absolute sovereign immunity than the FSIA's restrictive approach to sovereign immunity.[125] Broad interpretations of the functional necessity doctrine, in conjunction with the narrow interpretations of the exceptions set forth in their constitutive agreements, have led to calls from critics of international organizations to restrict intergovernmental immunity.[126]

121. Michael Singer, *Jurisdictional Immunity of International Organizations: Human Rights and Functional Necessity Concerns*, 36 VA. J. INT'L L. 53, 56 (1995).

122. Brower, *supra* note 120, at 19-20. Article 105 of the Charter provides that: "[t]he Organization shall enjoy in the territory of each of its Members such privileges and immunities as are necessary for the fulfillment of its purposes." U.N. Charter art. 105, para. 1.

123. *See* Steven Herz, *Rethinking International Financial Institution Immunity*, *in* INTERNATIONAL FINANCIAL INSTITUTIONS & INTERNATIONAL LAW 137, 155-57 (Daniel D. Bradlow & David B. Hunter eds., 2010) (discussing the doctrine of functional necessity and its application by domestic courts).

124. *See* 22 U.S.C. §§ 288-288f (2010) (defining international organizations and their privileges and immunities under U.S. law). In order for an international organization to be granted the privileges and immunities set forth in the IOIA, two requirements generally must be met: (i) the United States must be a member of such organization; and (ii) the President must issue an Executive Order designating the international organization as one entitled to enjoy the benefits of the IOIA. *See id.* at § 288 (defining international organizations and explaining how they are designated). *See also* Singer, *supra* note 121, at 66 n.43 (discussing the IOIA).

125. The IOIA provides, in relevant part, that international organizations "shall enjoy the same immunity from suit and every form of judicial process as is enjoyed by foreign governments, except to the extent that such organizations may expressly waive their immunity for the purpose of any proceedings or by the terms of any contract." 22 U.S.C. § 288a(b) (2010). *See* Atkinson v. Inter-Am. Dev. Bank, 156 F.3d 1335 (D.C. Cir. 1998); Mendaro v. World Bank, 717 F.2d 610 (D.C. Cir. 1983) (both finding that IFIs were entitled to broad-based claims to immunity in respect of tort actions brought by former employees).

126. *See* Steven Herz, *International Organizations in U.S. Courts: Reconsidering the Anachronism of Absolute Immunity*, 31 SUFFOLK TRANSNAT'L L. REV. 471, 492-513 (2008) (critiquing broad interpretations of intergovernmental immunity by U.S. federal courts). These critiques do not directly address regulatory immunity or global financial regulation, and this Article does not take a position on their substantive content.

3. Applications of International Privileges and Immunities to Global Finance

The situations in which international privileges and immunities are asserted by state-owned financial entities reflect the diverse ways in which they participate in the financial markets. Sovereign bond offerings have generally been treated as "commercial activity" under the FSIA, and are therefore not immune to suits brought by bondholders under federal securities law.[127] The same analysis would presumably apply to loans and equity support to private entities by central banks, equity investments by foreign government agencies, and SWFs.[128] In such cases, the threshold consideration is which sovereign act is the basis of the civil action against the state. For example, the imposition of exchange controls may be considered a governmental act, whereas the actual issuance of securities into global capital markets may be considered a commercial activity.[129] In either case, courts rely on their assessment of the private/commercial nature of the transaction or activity at issue, rather than the governmental purpose of such transaction or activity.[130]

In the case of IFIs, the application of intergovernmental immunity to their financial activities is muddled by differing interpretations regarding the scope of the functional necessity doctrine. In its most favorable and literal interpretation, any act relating to a core function may be entitled to immunity if it is deemed to be necessary for the functioning of the institution. Therefore, quite plausibly, loans to sovereign and non-sovereign borrowers, as well as to the capital reserves of IFIs themselves, would be immune from jurisdiction and attachment by a domestic court. Likewise, the borrowing and hedging activities of IFIs in international capital markets through issuing bonds and entering into derivatives transactions may be immune from suit given their importance to IFIs—notwithstanding the fact that, as commercial activities, such transactions would fall outside the protections of a restrictive theory of immunity. The constitutive agreements of IFIs appear to embrace this view, as reflected in the IBRD Articles of Agreement, which provides: "To the extent necessary to carry out the operations provided for in this Agreement and subject to

127. *See* HLR Note, *supra* note 83, at 556 (discussing the Supreme Court's test for whether an activity is entitled to immunity).

128. *See id.* at 565-66 (discussing how central bank support for private entities is treated as commercial activity).

129. *See* Greene & Adee, *supra* note 95, at 18-19 (examining sovereign immunity and its interaction with commercial activity). *See also* text accompanying note 107.

130. *See* Lee, *supra* note 86, at 371-74 (concluding that foreign exchange transactions would be treated as a commercial act, even if private sector banks do not engage in the sale of foreign exchange in a given market).

the provisions of this Agreement, all property and assets of the Bank shall be free from restrictions, regulations, controls and moratoria of any nature."[131]

Countervailing examples and counterarguments qualify this expansive view, however. For certain kinds of transactions, IFIs expressly agree to a carve-out of their intergovernmental immunity for particular types of financial activities in their constitutive agreements.[132] In many other instances, IFIs will agree *ex ante* to arbitration in contracts with counterparties.[133] More broadly, critics of IFIs point out that the functional necessity doctrine can only be satisfied if IFIs may be sued in accordance with the expectations of counterparties in the specific market in which they are transacting. According to these critics, absent an express waiver by an IFI, its intergovernmental immunity should be denied because such intergovernmental immunity places an undue burden on the ability of the IFI to exercise its functions in the market.[134] This view envisions a sliding scale of intergovernmental immunity in respect of IFIs' financial activities that would ratchet up or down based on the reasonable commercial expectations of their counterparties.

As is evident in the foregoing analysis, although international privileges and immunities may provide protection from legislative, judicial, or regulatory jurisdiction under international law, these doctrines predominantly arise in the context of litigation by private parties against

131. IBRD Articles of Agreement, *supra* note 88, at art. VII(6).

132. *See, e.g.*, *id.*, art. VII(3) (providing that "[a]ctions may be brought against the Bank only in a court . . . in which the Bank . . . has issued or guaranteed securities"). *See also* Rutsel Silvestre J. Martha, *International Financial Institutions and Claims of Private Parties: Immunity Obliges*, *in* THE WORLD BANK LEGAL REVIEW: INTERNATIONAL FINANCIAL INSTITUTIONS AND GLOBAL LEGAL GOVERNANCE 93, 122-24 (Hassane Cissé, Daniel D. Bradlow & Benedict Kingsbury eds., 2012) (examining the circumstances in which intergovernmental immunity might not be applicable).

For example, the ADB Agreement expressly carves out from the ADB's intergovernmental immunity any activities relating to the operation of the institution (*i.e.*, any financial activities not directly related to its development mandate), providing that:

> The Bank shall enjoy immunity from every form of legal process, except in cases arising out of or in connection with the exercise of its powers to borrow money, to guarantee obligations, or to buy and sell or underwrite the sale of securities, in which cases actions may be brought against the Bank in a court of competent jurisdiction in the territory of a country in which the Bank has its principal or a branch office, or has appointed an agent for the purpose of accepting service or notice of process, or has issued or guaranteed securities.

ADB Agreement, *supra* note 88, at art. 50 (emphasis added).

133. *See* Brower, *supra* note 120, at 78-79 (characterizing submission to international arbitration as the overwhelming practice of international organizations).

134. *See* Singer, *supra* note 121, at 136-37.

foreign states.[135] Due to the historical context in which these doctrines have evolved, their application to legal obligations imposed by foreign states through regulation is relatively untested.[136] Domestic regulators, which are not strictly obligated to follow jurisprudence interpreting the scope and application of international privileges and immunities, have dealt with regulatory immunity on a case-by-case basis. These instances of *ad hoc* administrative rulemaking provide a unique opportunity to evaluate existing rules and practices.

C. *Case Study: International Financial Institutions and the Regulation of Swaps under the Dodd-Frank Act*

The regulatory reforms enacted in the wake of the global financial crisis lead to newfound questions about the special legal status of state-owned financial entities. In particular, the implementation of the regulatory oversight of OTC derivatives mandated by the Dodd-Frank Act has become the focus of unprecedented attention. The relative openness of the administrative rulemaking process in the United States, coupled with the absence of any statutory guidance in the text of the Dodd-Frank Act itself, spurred the direct engagement of various state-owned financial entities throughout the world with U.S. financial regulators. The following analysis highlights the ongoing regulatory dialogue conducted by IFIs, individually and collectively.[137] The concerns raised by IFIs are shared by foreign central banks and other state-owned financial entities with similar operational and legal characteristics.[138] All of these institutions have cited

135. *See* Akehurst, *supra* note 33, at 118.

136. *See* Gaukrodger, *supra* note 112, at 51 (concluding that it is difficult to draw general conclusions about foreign state immunity from host state regulation due to the lack of specific treaty-based or statutory authority and the scarcity of state practice).

137. The foregoing discussion focuses on the outreach by multilateral development banks of which the United States is a member, which included, *inter alia,* members of the World Bank Group (*i.e.*, IBRD, IDA, IFC, and MIGA), the AfDB, the ADB, the EBRD, and the IDB.

138. *See, e.g.*, Letter from Günter Pleines, Bank for Int'l Settlements, to David A. Stawick, Sec'y, Commodity Futures Trading Comm'n and Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (July 20, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48005&SearchText= (commenting on the Proposed Rule entitled "Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping" (File Number S7-16-11) and arguing that the definition of "swap" and "security-based swap" should exclude deals with international public organizations). The European Central Bank ("ECB") claimed that the ECB and other foreign central banks would shift swaps activities away from U.S. markets or U.S. counterparties if not granted an exemption. *See* Letter from Antonio Sáinz de Vicuña, Eur. Cent. Bank, to Jacqueline Mesa, Director, Commodity Futures Trading Comm'n 7 (Oct. 11,

their international public missions, and the attendant legal protections thereunder, as a primary basis for excluding them from the jurisdiction of the Dodd-Frank Act. The analysis that follows reveals the extent to which assertions of international privileges and immunities may enable differential regulatory treatment. The malleability of these international law doctrines has provided substantial discretion to financial regulators to define the scope and conditions of state-owned financial entities' obligations.

Prior to the enactment of the Dodd-Frank Act, the OTC derivatives market—most notably, the market for swaps transactions—was predominantly subject only to indirect regulatory oversight.[139] The Dodd-Frank Act transforms the regulation of swaps in a variety of ways. Title VII of the Dodd-Frank Act establishes a new legal framework for the OTC derivatives market, including: (i) mandatory clearing of swaps transactions through central clearing parties and mandatory trading through either regulated exchanges or swap execution facilities; (ii) requiring the posting of collateral ("margin") for certain swaps transactions; (iii) requiring new categories of market participants—swap dealers and major swap participants—to register with the CFTC and/or SEC; and (iv) imposing new recordkeeping and reporting requirements on parties in swaps transactions.[140]

The derivatives activities of state-owned financial entities are not expressly referenced at all in the Dodd-Frank Act. Notably, the Dodd-Frank Act exempts the Federal Reserve from all regulation under Title VII while remaining silent about the treatment of foreign central banks and other state-owned financial entities with similar functions.[141] In response to

2011), *available at* http://comments.cftc.gov/PublicComments/View Comment.aspx?id=49816&SearchText= (commenting on Title VII of the Dodd-Frank Act and expressing concern that the ECB may fall under the definition of a major swap participant and thus become subject to regulation). *See also* Matt Cameron and Peter Madigan, *ECB Threatens to Stop Trading Swaps with US Banks*, RISK MAG., Nov. 2011, at 10 (noting the possibility that the ECB might end trading derivatives with U.S. markets if they are not given exemptions from Dodd-Frank Act regulations).

139. *See* Chander & Costa, *supra* note 74, at 658-61. An example of indirect regulation was the public disclosure of certain bilateral swaps contracts pursuant to mandatory reporting requirements under the Exchange Act; however, swaps trades were not subject to registration, risk provisioning, or capital requirements in the United States.

140. *See* Dodd-Frank Act §§ 711-754; *see also* Dan Awrey, *Regulating Financial Innovation: A More Principles-Based Proposal?*, 5 BROOK. J. CORP. FIN. & COM. L. 273, 299-303 (2011) (providing an overview of the objectives and proposed methods of regulating OTC derivatives markets under the Dodd-Frank Act). Other major aspects of Title VII include bolstering the authority of federal regulators to prosecute market abuses and requiring banks to "push-out" many swap activities to affiliates.

141. The Dodd-Frank Act excludes from the definition of swap "any agreement, contract, or transaction a counterparty of which is a Federal Reserve bank, the Federal

the resulting uncertainty, IFIs have engaged directly with the CFTC and SEC, the two federal agencies entrusted with the responsibility of enacting the rules that would clarify the scope of Title VII's mandate and provide operational details on its implementation.[142]

IFIs have expressed concerns about the implications of the Dodd-Frank Act on their derivatives activities in several respects:

First, IFIs have sought assurances that federal regulators will not categorize them as swap dealers or major swap participants, which would require IFIs to register with the CFTC and/or SEC and subject them to mandatory clearing and enhanced reporting and recordkeeping requirements, among other obligations.[143]

Second, IFIs have flagged the Dodd-Frank Act's clearing rules, which require that a swap transaction as a general rule be cleared through a clearinghouse.[144] An exemption to clearing is available to any swap counterparty that is a non-financial end-user (*i.e.*, not a swap dealer or a major swap participant) and uses swaps to hedge or mitigate commercial risk.[145] Therefore, under a plain language interpretation of the Dodd-Frank Act, an end-user that does not meet these requirements—such as a financial entity (as defined by the Dodd-Frank Act)—would be required to clear its swaps.

Third, IFIs have objected to being subject to margin requirements—*i.e.*, being required by law to post collateral with swaps counterparties.[146]

Government, or a Federal agency that is expressly backed by the full faith and credit of the United States." Dodd-Frank Act § 721 (47)(B)(ix).

142. *See* Deborah Solomon, *U.S. Regulators Aim to Extend Reach*, WALL ST. J., May 26, 2011 (explaining how U.S. regulators may impose restrictions on foreign governments engaging in financial transactions in the United States).

143. *See* Letter from Anne-Marie Leroy, Int'l Bank for Reconstruction and Dev. et al., to David A. Stawick, Sec'y, Commodity Futures Trading Comm'n 2-3 (Sept. 14, 2012), *available at* http://comments.cftc.gov/PublicComments /ViewComment.aspx?id=58958&SearchText= [hereinafter World Bank September 2012 Comment Letter] (commenting on the Proposed Rule entitled "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants" and both acknowledging and welcoming the CFTC's decision not to require multilateral development banks to register as swap dealers or major swap participants).

144. *See id.* at 3 (acknowledging and welcoming the CFTC's decision not to subject multilateral development banks to swap clearing requirements).

145. *See* Dodd-Frank Act § 723 (setting forth an exception to mandatory clearing for any swap in which one of the counterparties: "(i) is not a financial entity; (ii) is using swaps to hedge or mitigate commercial risk; and (iii) notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into noncleared swaps").

146. A party entering into a swap faces rate or market risk (*e.g.*, interest rate risk and currency risk) and counterparty credit risk. When rates move against a party, the party is said to be "out of the money." Conversely, when rates move in favor of a party, that party is said to be "in the money." Requiring a party that is out of the money to post collateral

Traditionally, IFIs, like their sovereign counterparts, have only agreed to receive collateral from swaps counterparties, not post collateral against swaps exposures.[147]

Finally, aside from the above-described concerns, IFIs have raised the possibility of residual and indirect regulation, even if IFIs are exempted from specific requirements.[148]

In their engagement with financial regulators, IFIs have employed a dual-pronged approach premised on their legally-defined missions and immunities under federal law and international treaties with the United States. First, IFIs have steadfastly cited the intergovernmental immunity set forth in their respective constitutive agreements, taking particular note of the prior practice of the United States to grant generally unqualified deference.[149] While not explicitly referencing the functional necessity

reduces market risk to the other party. SCOTT & GELPERN, *supra* note 9, at 966, 969.

147. *See* Letter from Anne-Marie Leroy, Int'l Bank for Reconstruction and Dev. et al., to David A. Stawick, Sec'y, Commodity Futures Trading Comm'n (Nov. 26, 2012), *available at* http://www.federalreserve.gov/SECRS/2012/November/20121130/R-1415/R-1415_112612_110877_688136176592_1.pdf [hereinafter World Bank November 2012 Comment Letter] (commenting on the Proposed Rule entitled "Margin and Capital Requirements for Covered Swap Entities" and seeking exemption from margin requirements on uncleared swaps entered into by multilateral development banks); *see also* David Rothnie, *Difficult Journey*, INT'L FIN. REV., Apr. 2012, at 10-12 (noting the historical reluctance of sovereigns and IFIs to posting collateral relating to swaps).

148. The World Bank, writing on behalf of itself and other multilateral development banks, argued that only "a comprehensive solution" would preclude the possibility of various forms of residual and indirect regulation, and proposed that the term "swap" be defined to exclude transactions with such institutions, thereby completely exempting them from the Dodd-Frank Act's requirements. *See* Letter from Vincenzo La Via, Int'l Bank for Reconstruction and Dev. et al., to David A. Stawick, Sec'y, Commodity Futures Trading Comm'n 6-8, attachment 2 (July 22, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47911&SearchText= [hereinafter World Bank July 2011 Comment Letter] (commenting on the Proposed Rule entitled "Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping" (File Number S7-16-11)).

149. *See id*. at 2-5 (referring to "well-settled United States legislation" and the EU's "consistent record of regulatory forbearance"); World Bank November 2012 Comment Letter, *supra* note 147, at 4-5 (referring to a legal opinion requested by, and provided to, the Chairman of the CFTC that concluded regulation of IBRD and IFC would constitute a breach by the United States of its international obligations and that the Dodd-Frank Act does not authorize any curtailment of those institutions' intergovernmental immunity); Letter from Soren Elbech, Treasurer, Inter-American Dev. Bank, and J. James Spinner, General Counsel, Inter-American Dev. Bank, to David A. Stawick, Sec'y, Commodity Futures Trading Comm'n (July 22, 2011), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47925&SearchText=; Letter from Isabelle Laurent, Deputy Treasurer and Head of Funding, European Bank for Reconstruction and Dev., to Jacqueline Hamra Mesa, Dir., Office of Internal Affairs, Commodity Futures Trading Comm'n (July 22, 2011), *available at*

doctrine, IFIs have pointedly emphasized the importance of their derivatives activities to the fulfillment of their institutional mandates.[150] Second, IFIs have emphasized their political uniqueness, as reflected in their legally-defined international public missions and collective governance structures.[151]

The arguments advanced by IFIs have a broader application to the concerns regarding extraterritorial regulation shared with other state-owned financial entities. The difficulty of relying on territoriality as a threshold principle is underscored by the fact that several IFIs and numerous other international organizations are headquartered in the United States.[152] The World Bank, on behalf of itself and other international organizations, has consistently taken the position that it is not a U.S. person due to its legal character as an international organization and the offshore nature of its development activities.[153] Further, IFIs have justified their use of swaps based on their intended purpose to hedge currency, interest rate, and other market risks arising from their lending, borrowing, equity management, and investment operations.[154] Accordingly, IFIs argue that the regulation of their relatively low-risk hedging activities should be considered to be outside the scope of the Dodd-Frank Act and therefore left unregulated.[155]

The CFTC, as the primary regulator of IFIs' swaps activities, has largely embraced the positions advanced by IFIs in applicable rulemaking

http://comments.cftc.gov/PublicComments/ViewExParte.aspx?id=314&SearchText=.

150. *See* World Bank July 2011 Comment Letter, *supra* note 148, at 8 (stating that "[t]he use of derivatives for risk management purposes is integral to the development operations of the IBRD, IFC, and other MDBs").

151. *See id*. at 6 (describing the management of IBRD and IFC by their respective sovereign shareholders, including the United States, and the direct oversight authority of their respective boards and audit committees over financial operations); World Bank September 2012 Comment Letter, *supra* note 143, at 6-7 (describing how margin requirements would impair the development effectiveness of multilateral development banks).

152. Among such entities are the World Bank, the IMF, the IDB, and the United Nations.

153. *See* World Bank July 2011 Comment Letter, *supra* note 148, at 4. *See also* Letter from Kenneth E. Bentsen, Jr., Exec. Vice President, Public Policy and Advocacy, Sec. Indus. and Fin. Markets Ass'n, to David A. Stawick, Sec'y, Commodity Futures Trading Comm'n (Aug. 27, 2012), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58652&SearchText= (recommending that the CFTC exclude supranational organizations from the definition of U.S. person in order to "promote international comity and harmonization of international swap regulation") [hereinafter SIFMA Comment Letter].

154. *See* World Bank July 2011 Comment Letter, *supra* note 148, attachment 1 (describing how multilateral development banks use swaps).

155. *See* World Bank September 2012 Comment Letter, *supra* note 143, at 5-6 (claiming that the imposition of margin requirements would be inconsistent with the CFTC's statutory mandate and would serve no policy purpose).

to date. In exempting IFIs from registration as swap dealers or major swap participants, the CFTC determined:

> [T]he sovereign or international status of foreign governments, foreign central banks and international financial institutions that themselves participate in the swap markets in a commercial manner is relevant in determining whether such entities are subject to registration and regulation as a major swap participant or swap dealer. Canons of statutory construction "assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws." There is nothing in the text or history of the swap-related provisions of Title VII to establish that Congress intended to deviate from the traditions of the international system by including foreign governments, foreign central banks and international financial institutions within the definitions of the terms "swap dealer" or "major swap participant," thereby requiring that they affirmatively register as swap dealers or major swap participants with the CFTC and be regulated as such. The CFTC does not believe that foreign governments, foreign central banks and international financial institutions should be required to register as swap dealers or major swap participants.[156]

Relying on similar reasoning and expressly citing international comity and the "traditions of the international system", the CFTC has also exempted foreign governments, foreign central banks, and IFIs from the Dodd-Frank Act's clearing requirements.[157] However, the CFTC refrained from applying a blanket regulatory exemption to IFIs' swaps activities, choosing not to accept the World Bank's initial proposal.[158] Rules addressing the treatment of IFIs in respect of any applicable margin requirements for uncleared swaps remain pending.[159]

156. Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 Fed. Reg. 30,596, 30,693 (May 23, 2012) (internal citations omitted).

157. End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,560, 42,562 (July 19, 2012).

158. A complete carve-out for foreign and multinational public entities on the basis of international privileges and immunities appeared to be viewed as a viable option by at least one CFTC Commissioner during the rulemaking process. *See* Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Statement of CFTC Commissioner Jill Sommers re: Transactions Involving Certain Foreign or Multinational Entities, 76 Fed. Reg. 29,818, 29,899-900 (proposed May 23, 2011) (advocating for the preservation of international privileges and immunities for multinational public organizations in order to avoid hindering their operational effectiveness).

159. *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (proposed Apr. 28, 2011); Margin and Capital

III. GLOBAL FINANCIAL REGULATION AS COMITY

Claims of freedom from the regulatory authority of a government highlight the potential for conflict arising from the juxtaposition of two complementary legal concepts: national sovereignty and international privileges and immunities. The special treatment of state-owned financial entities due to their sovereign status casts in high relief the unique friction points in the governance of the global economy, in which there is no unified meta-sovereign rulemaking and enforcement authority. This is certainly evident in derivatives regulation. The implementation of mandatory rules governing swaps transactions constitutes an abrupt transformation in a heretofore largely unregulated area. As apparent in the CFTC's rulemaking concerning foreign central banks and IFIs, the application of international privileges and immunities is marked by an ambiguously-defined compromise between market equality and sovereign prerogative.

A. *The Systemic Legitimacy of State-Owned Financial Entities*

International privileges and immunities, as applied by domestic financial regulators, are justified on the very terms on which they were created: to respect international comity by preserving the authority of each state to govern within its own borders and in respect of its own subjects.[160] Similarly, the intergovernmental immunity afforded to international organizations reflects the exclusive nature and purpose of their activities, which may be viewed as express and implicit delegations of sovereign authority by their respective member states.[161] A key distinction between international organizations and their state counterparts is the doctrine of functional necessity, reflected in the absence of a commercial activity exception to intergovernmental immunity.[162] In comparison to sovereign

Requirements for Covered Entities, 76 Fed. Reg. 27,564 (proposed May 11, 2011). *See also* Semiannual Agenda of Regulations, 78 Fed. Reg. 44,394, 44,394 (July 23, 2013) (noting the re-opening of the comment period on proposed rules regarding margin and capital requirements for covered swap entities); 78 Fed. Reg. 43,785, 43,794 n.63 (noting that the CFTC has not yet finalized these rules).

160. *See* Lori Fisler Damrosch, *Changing the International Law of Sovereign Immunity Through National Decisions*, 44 VAND. J. TRANSNAT'L L. 1185, 1187 (2011) (noting and critiquing references to comity in Supreme Court decisions addressing sovereign immunity).

161. *See* Singer, *supra* note 121, at 127; *see also* Martha, *supra* note 132, at 97 (characterizing IFIs as "providers of international public goods" that its member states have determined cannot be provided by themselves).

162. Domestic regulators that are not accustomed to parsing the doctrinal subtleties of international privileges and immunities may blur this distinction. In determining that IFIs were not required to register as swap dealers or major swap participants, it appears that the

immunity, the more absolute approach of intergovernmental immunity may be justified by the fact that IFIs, notwithstanding their considerable capital assets and broad economic mandates, lack the territorial sovereignty enjoyed by states and have more limited means of enforcing international legal commitments through extrajudicial means.[163]

These legal entitlements have prescriptive and normative implications for global financial regulation. First, governance gaps may arise if conflicts between extraterritorial regulation and international privileges and immunities are resolved differently across jurisdictions. On the one hand, it may be argued that the regulatory diversity resulting from differential treatment of such institutions may be desirable insofar as it implicitly enables cost-benefit analysis of extraterritorial jurisdiction based on regulatory priorities.[164] On the other hand, however, such gaps may be suboptimal in other respects. One possibility is that regulatory diversity may lead to uncertainty among private market participants and other regulators about the future treatment of state-owned financial entities.[165]

Second, even if there is regulatory consistency across jurisdictions, the discretionary regulation of state-owned financial entities may perpetuate doubts about the legitimacy of global financial regulation.[166] The challenge of legitimacy applies generally to any global governance regime in which there is a tension between the accountability of domestic regulators to their own citizenry and their accountability to foreign regulatory counterparts.[167] The issue of systemic legitimacy is most apparent in respect of the dual-faced roles of foreign central banks and IFIs, which operate as market

CFTC implied that the intergovernmental immunity granted to IFIs is qualified by the commercial activity exception based on the restrictive approach to immunity. *See* 77 Fed. Reg. at 30,693. The World Bank subsequently requested clarification and a correction on this point. *See* World Bank September 2012 Comment Letter, *supra* note 142, attachment 3.

163. *See* Brower, *supra* note 120, at 16-17 (analyzing the motivations for and complications arising from the application of sovereign immunity concepts to international organizations).

164. *See* José E. Alvarez, *The Return of the State*, 20 MINN. J. INT'L L. 223, 258 (2011) (observing that fragmented global governance may reflect forum-shifting/forum-shopping by empowered states to serve their own interests); Harlan Grant Cohen, *Finding International Law, Part II: Our Fragmenting Legal Community*, 44 N.Y.U. J. INT'L L. & POL. 1049, 1103–06 (2012) (outlining a "competition/politics" response to fragmentation).

165. *See* Pierre-Hugues Verdier, *Mutual Recognition in International Finance*, 52 HARV. INT'L L.J. 55, 68 (2011) (noting the considerable uncertainty states face in respect of each other's regulatory systems).

166. *See* BRUMMER, *supra* note 28, at 330-32 (describing the particularly problematic legitimacy of global financial regulation in comparison to purely domestic regulation).

167. *See* Kalypso Nicolaidis & Gregory Shaffer, *Transnational Mutual Recognition Regimes: Governance Without Global Government*, 68 LAW & CONTEMP. PROBS. 263, 267-68 (Summer/Autumn 2005) (noting the effect of state recognition of external policies on the domestic policies of those states).

participants and also function as regulatory supervisors and advisers in the international financial architecture. The granting of regulatory immunity to such state-owned financial entities may therefore raise unique legitimacy questions. The effectiveness of central banks and IFIs in projecting state regulatory power is premised on perceptions of their legitimacy.[168] Legitimacy criteria fall under two broad categories: input legitimacy and output legitimacy. Input legitimacy focuses on the means of lawmaking and considers whether the lawmaking process is representative and procedurally fair.[169] Output legitimacy focuses on the content of laws and considers whether the laws themselves meet a normative standard based on what is deemed to be right, acceptable, desired, or just.[170] The malleability of international privileges and immunities in respect of extraterritorial regulation offers the advantages of *ad hoc* lawmaking to a unique class of market participants. From an output legitimacy perspective, however, the possibility of being granted regulatory immunity may incentivize inefficient, rent-seeking behavior by state-owned financial entities based on selective assertions of international privileges and immunities and the structuring of their market activities to permit maximum use of such privileges and immunities.[171] From an input legitimacy perspective, the domestically-driven administrative law process of determining the scope of regulatory immunity may lack sufficient constructive visibility commensurate with the global scope of the resulting substantive rules.[172]

168. *See* Thomas M. Franck, *Legitimacy in the International System*, 82 AM. J. INT'L L. 705, 706 (1988) (defining legitimacy as the "quality of a rule which derives from a perception on the part of those to whom it is addressed that it has come into being in accordance with right process") (italics removed). *See also* Dana Brakman Reiser & Claire R. Kelly, *Linking NGO Legitimacy and the Legitimacy of Global Governance,* 36 BROOK. J. INT'L L. 1011, 1014-15 (2011) (describing legitimacy as "socially constructed").

169. *See* BRUMMER, *supra* note 28, at 323 (noting the importance of democratic processes to input legitimacy); Claire R. Kelly, *Institutional Alliances and Derivative Legitimacy*, 29 MICH. J. INT'L L. 605, 608, 614-19 (2008) (describing the importance of representation and other features in establishing input legitimacy).

170. *See* Kelly, *supra* note 169, at 608, 619-22 (describing the features that create results-based output legitimacy).

171. *See* José E. Alvarez, *Governing the World: International Organizations as Lawmakers*, 31 SUFFOLK TRANSNAT'L L. REV. 591, 598 (2008) (observing that the conduct of international organizations has normative consequences independent from the authority delegated to them by states).

172. *See* Caroline Bradley, *Consultation and Legitimacy in Transnational Standard-Setting*, 20 MINN. J. INT'L L. 480, 501 (2011) (noting the importance of broad-based visibility of regulatory consultation processes to the perceived legitimacy of their ends); Pierre-Hugues Verdier, *U.S. Implementation of Basel II: Lessons for Informal International Lawmaking*, *in* INFORMAL INTERNATIONAL LAWMAKING 437, 438-39 (Joost Pauwelyn et al. eds., 2012) (noting the limitations of domestic implementation as a means of addressing external accountability to other countries and their banks, firms, and consumers).

Even if domestic administrative lawmaking concerning international privileges and immunities is carried out in accordance with public participatory principles, such as the "notice-and-comment" procedures required by the Administrative Procedure Act (APA), the legitimizing process may be too attenuated from the stakeholders that may be affected by it.[173] Further, the legitimacy of central banks and IFIs may be adversely impacted by disagreement or inconsistency among private market participants about the scope of the special treatment granted to them.[174] The doctrinal indeterminacy of regulatory immunity—reflected in good-faith differences of opinion among subjects of extraterritorial regulation—may undermine the compliance "pull" of the broader set of rules that compose global financial regulation.[175] The broad-based regulatory and supervisory powers of states and international organizations may be consequently compromised by doubts about their ability to engage with stakeholders as an "honest broker".[176]

B. Principles of Global Financial Comity

International privileges and immunities are at once too blunt and too inchoate to address considerations of comity, national sovereignty, and systemic legitimacy in global financial regulation. In their current form, the blanket application of these doctrines is not conducive to a holistic,

173. *See* BRUMMER, *supra* note 28, at 331 (noting the legitimating function of domestic political participation in the lawmaking process).

174. For example, in the context of the Dodd-Frank Act's regulation of derivatives, this is arguably evident in comments from SIFMA and ISDA, two prominent industry associations, concerning the application of margin requirements to foreign central banks and IFIs. *Compare* Letter from Robert Pickel, CEO, Int'l Swaps and Derivatives Ass'n, et al., to David A. Stawick, Sec'y, Commodity Futures Trading Comm'n 6-7 (Sept. 14, 2012), *available at* http://www2.isda.org/attachment/NDc5Nw==/ISDA-SIFMA-CFTCMarginCommentLetter091412.pdf (commenting on CFTC RIN 3038-AC97 - Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants and qualifiedly supporting the exemption of sovereigns, central banks, and IFIs from margin requirements for non-cleared swaps), *with* Letter from Robert Pickel, CEO, Int'l Swaps and Derivatives Ass'n, to the Office of the Comptroller of the Currency, et al. 10-11 (Nov. 26, 2012), *available at* http://www2.isda.org/attachment/NTEwMA==/Margin%20for%20Uncleared%20Letter.pdf (commenting on the proposed rulemaking regarding Margin and Capital Requirements for Covered Swap Entities, and stating "that all sovereigns and central banks should post margin in order to achieve international comity").

175. *See* Franck, *supra* note 168, at 713-25 (discussing how different factors of determinacy affect the legitimacy of rules).

176. *See* Kelly, *supra* note 169, at 625-26 (observing that the effectiveness of international organizations depends in part on their perceived responsiveness to the demands of civil society and the interests that they represent).

transparent assessment of the diverse situations in which state-owned financial entities participate in global financial markets. Given a regulatory environment in which private market participants are subject to increasingly far-reaching regulatory oversight, it stands to reason that there may be countervailing factors warranting the extension of these requirements to their public counterparts. Further thereto, it has been suggested that certain government instrumentalities and international organizations should be regulated as international legal persons, with the attendant rights and obligations of multinational corporations and other private actors.[177]

This goes too far. Notwithstanding the legitimacy concerns implicated by their application, international privileges and immunities do—and, moreover, should—remain salient. In the context of the global financial system, these privileges and immunities formalize the unique public missions and public governance of the state-owned financial entities that enjoy them. More than simply permitting such public entities to participate in the financial markets, these doctrines provide the predictability and stability necessary to incentivize and empower them to act in the best interests of their shareholders (*i.e.*, states and their citizens) in their dual capacities as regulators and market participants. The shortcomings of international privileges and immunities are a symptom of the conceptual limitations of international law to address the complexities caused by the convergence of public and private law, rather than a cause.[178]

Comity as a means of allocating regulatory authority is hampered by the increasingly diffuse, decentralized structure of the international financial architecture.[179] Thus, the fundamental question is how to operationalize the principles of comity on which international privileges and immunities are based. A framework for global financial comity is one response. Its normative principles address two interrelated concerns implicated by the presence of state-owned financial entities in the market: first, by calibrating the role of the state in fragmented, multilayered global governance regimes and second, by contextualizing the distinction between public and private legal responsibility. First, global financial comity takes into account the interdependence of the state's responsibilities as a regulator and its rights as a market participant. By calibrating their own

177. *See* Alvarez, *supra* note 171, at 610 (noting the work of the U.N. International Law Commission to delineate the responsibility of international organizations with legal liability).

178. *See* Backer, *supra* note 97, at 499-500.

179. *See* Joel P. Trachtman, *Economic Analysis of Prescriptive Jurisdiction*, 42 VA. J. INT'L L. 1, 56-57 (2001) (observing that the effectiveness of comity may be dependent on the size of the group).

authority to regulate extraterritorially on the willingness to apply the same process of lawmaking (but not necessarily the same rules or substantive outcomes) to their own state-owned financial entities, states and their intergovernmental agents enhance the legitimacy of their actions.[180] This process of norm internalization requires states to recognize the benefits of engaging with multiple regulators across regulatory regimes.[181] Second, global financial comity permits a more nuanced, context-specific conception of public and private domains in international law. A pluralistic approach to regulation more accurately reflects the dynamic, fluid relationships of global finance.[182] Instead of invoking the principle of comity without substantive context, extraterritorial regulation and exceptions thereto (whether based on international privileges and immunities or on any other grounds in respect of any party, public or private) would rely on normative persuasion, cost-benefit analysis, or other metrics deemed appropriate.[183] Embracing the inherently political nature of global financial regulation would be another consequence. By "foregrounding" the political dynamics that underlie assertions of extraterritorial regulatory authority and international privileges and immunities, regulators and market participants may be able to engage in a more transparent dialogue regarding their intentions and constraints.[184]

There are a variety of institutional mechanisms through which global financial comity could be carried out. The Dodd-Frank Act includes numerous mandates requiring administrative agencies to consult and

180. *See* Parrish, *supra* note 33, at 870 (arguing that international norms and procedures in lieu of extraterritoriality enhance, rather than detract from, state power by legitimizing a state's meta-objectives).

181. *See* Robert B. Ahdieh, *From Federal Rules to Intersystemic Governance in Securities Regulation*, 57 EMORY L.J. 233, 240-44 (2007) (describing the importance of coordination and regulatory persuasion, instead of hierarchical regulatory control). *See also* Abbott & Snidal, *supra* note 68, at 573-77 (describing the potential role of states and international organizations as facilitative orchestrators).

182. *See* Paul Schiff Berman, *From International Law to Law and Globalization*, 43 COLUM. J. TRANSNAT'L L. 485, 523 (2005) (characterizing the distinction between state policy and private agreement as "always problematic . . . [and] increasingly irrelevant").

183. *See* Paul Schiff Berman, *A Pluralist Approach to International Law*, 32 YALE J. INT'L L. 301, 318-20 (2007) (noting the importance of the mutual benefits underlying comity); Ming-Sung Kuo, *Inter-Public Legality or Post-Public Legitimacy? Global Governance and the Curious Case of Global Administrative Law as a New Paradigm of Law*, 10 INT'L J. CONST. L. 1050, 1073-74 (2012) (noting the primacy of public dialogue on the legitimacy of law within extralegal politics).

184. *See* David Kennedy, *The Mystery of Global Governance*, *in* RULING THE WORLD? CONSTITUTIONALISM, INTERNATIONAL LAW, AND GLOBAL GOVERNANCE 37, 57-60 (Jeffrey L. Dunoff & Joel P. Trachtman eds., 2009) (noting the dangers of disregarding the distributive effects of politics on global governance lawmaking).

coordinate with their foreign regulatory counterparts.[185] Instead of solely viewing these mechanisms as a means of coordinating and enforcing regulatory action, regulators may be able to use them to facilitate constructive dialogue with market participants on a global scale.[186] Administrative law procedures in different jurisdictions could be expanded to promote dialogue among a broader group of stakeholders, including domestic regulators, international organizations, and various non-state actors.[187] Specifically with respect to the assertion of international privileges and immunities, these coordinating mechanisms would provide a forum for state-owned financial entities to express their interests, recognize conflicting policy objectives, and prescribe shared fundamental values to guide regulation.[188]

The Financial Stability Board established by the G20 may be one appropriate forum for the promulgation of the rules and objectives for such institutional dialogue. Towards that end, an international administrative law agency with enforcement powers could serve as an institutional forum for the identification of interests and resolution of disputes.[189] Granted, it is unlikely that state-owned financial entities would be willing to voluntarily cede autonomy over their operational practices to an autonomous international body.[190] Alternatively, domestic administrative lawmaking processes could institutionalize and formalize existing modes of input. These modes of input would grant deference to foreign rulemaking as

185. For example, the Dodd-Frank Act requires the CFTC, the SEC, and prudential regulators to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps . . . and may agree to such information-sharing arrangements as may be deemed to be necessary or appropriate in the public interest or for the protection of investors [and] swap counterparties." Dodd-Frank Act § 752(a).

186. The effectiveness of social acculturation is premised on the interactions among regulators and market participants leading to greater cooperation, coordination, and compliance. *See* Verdier, *supra* note 71, 164-65, 171 (noting the need for more detailed empirical analysis in the context of transgovernmental regulatory networks).

187. *See* Reiser & Kelly, *supra* note 168, at 1016-17; *see also* Benedict Kingsbury, Nico Krisch & Richard B. Stewart, *The Emergence of Global Administrative Law*, 68 LAW & CONTEMP. PROBS. 15, 33 (Summer/Autumn 2005) (approvingly noting the use of notice-and-comment procedures in the United States that take into account international negotiations among regulators).

188. *See* Weber, *supra* note 66, at 692-94 (arguing for the development and identification of common core values for establishing a system of multilayered governance).

189. *See* Pan, *supra* note 15, at 280 (noting the dispute settlement powers of the European System of Financial Supervisors).

190. Notwithstanding, in this respect, the Santiago Principles concerning the disclosure and corporate governance practices of SWFs could arguably be distinguished from the financial activities of central banks and IFIs insofar as the diversity of SWF practices and the relatively new and unsettled nature of SWFs' equity investments may incentivize SWF states to agree to a voluntary code of conduct.

referenced by third party private market participants.[191] Similarly, legally non-binding standards set forth by transgovernmental regulatory networks pursuant to notice-and-comment procedures may be used as an additional reference point.[192]

In all of these instances, state-owned financial entities would retain a rebuttable presumption of legality that would be conditioned on identifying a reasonable public basis for their market activities and applying any available international privileges and immunities to the extent necessary for such entities to carry out these expressed public objectives.[193] Although this procedural framework does not dictate the adoption of particular substantive rules, it would suggest a shift away from formalist rulemaking towards functionalist approaches to conflicts between extraterritorial regulation and national sovereignty. For example, the adoption of a "purpose" based test for determining whether financial activities of a sovereign entity constitute "commercial activity" would provide a means

191. For example, private market participants have expressly cited the anti-competitive impact of divergent treatment by U.S. and EU regulators in respect of derivatives regulation:

> [T]he imposition of margin requirements on foreign sovereigns would have a serious anti-competitive impact on U.S. swap entities in relation to their foreign competitors. Assuming non-U.S. jurisdictions create margin rules, foreign regulators are unlikely to apply onerous margin requirements to transactions with their sovereign. Recent discussions within Europe indicate a difference between the European Union ("E.U.") approach and the U.S. approach. For example, in a recent letter from the senior officials of the European Central Bank ("ECB") to the CFTC and the SEC, the ECB asks the Commissions to exclude from the definition of "swap" and "security-based swap" any agreement, contract, or transaction in which one counterparty is a public international organization, such as the ECB, or a national central bank of a market economy. If the E.U. excludes such entities from its margin requirements while the U.S. margin rules capture such entities, U.S. swap entities will be placed at a severe disadvantage in competing for the business of sovereign counterparties.

Letter from Robert Pickel, CEO, Int'l Swaps and Derivatives Ass'n, to the Office of the Comptroller of the Currency, et al. 12 (July 6, 2011) *available at* http://www.federalreserve.gov/SECRS/2011/November/20111122/R-1415/R-1415_070611_81727_628897276954_1.pdf (commenting regarding Margin and Capital Requirements for Covered Swap Entities).

192. In respect of the applicability of derivatives regulation to sovereign and supranational entities, the Basel Committee on Banking Supervision and IOSCO have determined, after requesting comments on a prior draft report, that sovereigns, central banks, multilateral development banks, and BIS should not be required to collect or post margin. *See* BASEL COMMITTEE ON BANKING SUPERVISION AND BOARD OF THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, *Second Consultative Document, Margin Requirements for Non-Centrally Cleared Derivatives* 7 (Feb. 2013), *available at* http://www.bis.org/publ/bcbs242.pdf.

193. *See* Buxbaum, *supra* note 34, at 307-08 (identifying the importance of state consent in transnational economic regimes).

for explaining, justifying, and contextualizing the financial activity in question.[194] In respect of derivatives regulation, the CFTC has articulated a principle that expressly distinguishes SWFs from other foreign state-owned financial entities due to the different nature of their respective commercial activities.[195] The European Union has followed a substantively similar—but not identical—approach, independent of the Dodd-Frank Act rulemaking process, under derivatives rules promulgated by the European Market Infrastructure Regulation (EMIR).[196]

Another regulatory technique to institutionalize global financial comity is through mutual recognition regimes. Mutual recognition circumscribes the application of extraterritorial regulation by allowing regulators to recognize another jurisdiction's standards as an adequate substitute, if not functionally equivalent. Accordingly, foreign firms or activities that comply with their home state's regulation may be exempted from compliance with the host state's regulatory requirements.[197] One of the primary benefits of mutual recognition is to facilitate recognition of the benefits of integration and promote dialogue among disparate market actors regarding substantive goals, without requiring substantive harmonization of two or more countries' laws.[198] In contrast to extraterritorial regulation of global economic activity based on the unilateral projection of domestic law, mutual recognition consists of extraterritorial lawmaking premised on the intermingling of multiple domestic laws to constitute the global.[199] Of particular note, U.S. financial regulators are currently exploring a variant of mutual recognition through the concept of "substituted compliance."[200]

---

194. *See* HLR Note, *supra* note 83, at 568-69 (endorsing the use of a "sovereign purpose" test); Gaukrodger, *supra* note 112, at 52-53 (noting the importance of the type of foreign state entity for purposes of determining whether it should be entitled to regulatory immunity).

195. To cite one example, the CFTC determined that "registration and regulation as a swap dealer or major swap participant under such circumstances may be warranted . . . for foreign corporate entities and sovereign wealth funds, which act in the market in the same manner as private asset managers." 77 Fed. Reg. at 30,693. *See also* Gaukrodger, *supra* note 112, at 53 (identifying "clearly commercial acts" as a basis for precluding regulatory immunity).

196. EMIR exempts multilateral development banks and any other entities that are both owned by central governments and have explicit central government guarantees from its jurisdiction, with the exception of certain reporting obligations. *See* Regulation on OTC Derivatives, Central Counterparties and Trade Repositories, Regulation (EU) No 646/2012, July 4, 2012, art. I(5)(a), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF.

197. Verdier, *supra* note 165, at 57.

198. *See id*. at 65-66; Paul Schiff Berman, *Global Legal Pluralism*, 80 S. CAL. L. REV. 1155, 1124 (2007).

199. *See* Nicolaidis & Shaffer, *supra* note 167, at 266-68.

200. *See* 78 Fed. Reg. at 43,786 (determining that the CFTC's implementation of

Under this regime, a foreign financial entity would be permitted to substitute compliance with its home state's derivatives rules (in lieu of the requirements of the Dodd-Frank Act to which it would otherwise be subject) so long as the foreign home state's regulatory requirements, in the view of the appropriate U.S. financial regulator, are deemed to be comparable.[201] The inclusion of state-owned financial entities in this regime, which could take into account the unique public supervisory oversight to which their activities are subject, would enhance the systemic legitimacy of global financial regulation.

CONCLUSION: SOVEREIGNTY AND THE GLOBAL MARKET

This Article is intended to be both interstitial and universal in focus. By examining the cross-border regulation of state-owned financial entities, it seeks to identify and clarify the legal issues applicable to an important class of actors in global financial markets. In the process, this Article seeks to highlight the paramount importance of legitimacy to global financial regulation and to shed light on how legitimacy claims are subject to the means by which regulatory authority is exercised as well as to the legal entitlements of market participants.

The power to regulate extraterritorially is both a reflection and an instrument of national sovereignty that defines, augments, and refines state power. The presence of state-owned financial entities in global financial markets highlights one of numerous tensions in the relationship between transnational economic activity and the nation-state. The existence of international privileges and immunities underscores the importance of balancing the objectives of extraterritorial regulation with the prerogatives of central banks and IFIs in their dual capacities as regulators and market participants. The framework of global financial comity outlined in this Article attempts to harmonize the doctrines of international privileges and immunities with the overlapping extraterritorial, decentralized, and multilayered financial governance regimes of the twenty-first century. A more refined, pluralistic application of international privileges and immunities may facilitate the participation of a broader group of private

---

substituted compliance requires additional time, at least through the end of 2013); *see also* CFTC, *The European Commission and the CFTC reach a Common Path Forward on Derivatives*, PR6640-13, July 11, 2013, *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6640-13.

201. *See* 77 Fed. Reg. at 41,232-34 (outlining the process for determining substituted compliance). One of the premises on which substituted compliance is being considered is the adoption of regulatory requirements by non-U.S. regulators that are similar to certain U.S. rules. In other words, the availability of substituted compliance is premised on partial harmonization. *See* 78 Fed. Reg. at 878.

and public market participants, and continue to encourage central banks, IFIs, and similar state-owned financial entities to apply such tenets to their own conduct.

Looking more expansively, the principles and objectives of global financial comity are of potential value to financial regulation generally. The development, institutionalization, and effectiveness of the current administrative agency practices described in this Article—such as consultations between U.S. financial regulators and their foreign counterparts on parallel rulemaking and the implementation of substituted compliance under the Dodd-Frank Act—are areas worthy of future empirical study. This exploration is part of a broader need to examine the relevance of long-standing legal doctrines, such as international privileges and immunities, amidst structural changes in the international economy. The future evolution of global financial regulation requires careful consideration of how these doctrines are applied in order to ensure that they protect the legal rights of their holders while not unduly hindering the development of new governance regimes that may incorporate transgovernmental regulatory networks, mutual recognition, self-regulation, and public-private partnerships, among other possibilities.