Banking on the Edge

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What's old is new again. The risks of international banking have returned to prominence in the wake of the Russian invasion of Ukraine. Global banks are playing a central role in the economic sanctions regime imposed upon Russia in response to its acts of military aggression. Foreign banks have retrenched from serving the Russian economy. International markets for debt, equity, and commodities are experiencing significant disruptions. The solvency measures and quarterly earnings of global banks have been impacted. These risks are new versions of an old story. International banking has been a fraught endeavor dating back more than a century. Despite their significance, the international operations of U.S. banks are often overlooked by legal scholarship.

This Article fills in some of this picture by examining the evolution of U.S. banks' global presence through the lens of an underappreciated, but significant, law: the Edge Act of 1919. The Edge Act began as a framework for privatizing the post-World War I rebuilding effort. Its drafters argued that promoting the competitiveness of U.S. banks abroad would expand U.S. commerce, manufacturing, and exports. Instead, through a series of legislative amendments and misadventures with overseas expansion, the Edge Act became a vehicle for global banking conglomerates to operate lightly regulated overseas "nonbank-banks." International banking policy came to prioritize the U.S. financial sector as its primary beneficiary, with deregulation as the predominant vehicle for achieving this goal.

The Edge Act is a case study for evaluating the longstanding desire to ensure that U.S. banks remain globally dominant. The results of eroding geographic and activity limitations include exposure to evolving risks—including sovereign debt crises, commodity price shocks, currency market risks, money laundering, derivatives dealing, and the growing use of financial sanctions—as well as increasing financialization, and an historic global financial crisis. As the experience of the Edge Act demonstrates, claims about the value of financial deregulation and its connection to international competitiveness should be treated with skepticism.

The appropriate role of global financial institutions is likely to be an issue of continued relevance as the emergence of nascent digital asset markets and digital

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banking models challenge the spatial and conceptual borders of financial markets. Without a thorough reexamination of the purposes and functions of international banking as we know it, beginning with the Edge Act, global banks may continue to exploit legal structural complexity in the name of international competition. As the case of the Edge Act demonstrates, such opportunistic use of regulatory arbitrage exposes the public to significant financial risk.

I. INTRODUCTION

In April 2012, the name "Whitefriars" went from obscurity to relative notoriety in financial circles. A number of business media outlets had reported that a single JPMorgan trader, who had come to be known among industry participants as the "London Whale," had been taking large positions in certain bespoke and illiquid credit derivatives markets.[1] A month later, JPMorgan Chase would disclose that it had lost more than $2 billion on these trades; its losses eventually grew to more than $6 billion.[2] Post-mortem analyses of the London Whale trades uncovered inadequate management oversight of the activities in the company's Chief Investment Office (CIO),[3] resulting in an enforcement action and $300 million penalty from the Federal Reserve (Fed).[4]

A technocratic narrative emerged from the London Whale episode, focusing on inadequate risk measurements and complex products gone awry, particularly whether the relevant trades should have been classified as permissible risk-mitigating hedging transactions or prohibited proprietary positions.[5] Less appreciated was the fact that dispersion of financial activities across a sprawling complex of legal entities had resulted in both a lack of

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1 *See* Gregory Zuckerman & Katy Burne, *'London Whale' Rattles Debt Market*, WALL ST. J. (Apr. 6, 2012), https://perma.cc/XW52-6YX9; *see also* Shannon D. Harrington, Bradley Keoun & Christine Harper, *JPMorgan Trader Iksil Fuels Prop-Trading Debate With Bets*, BLOOMBERG (Apr. 9, 2012), https://perma.cc/4YEV-X7XT.

2 *See* Patricia Hurtado, *The London Whale*, BLOOMBERG (Feb. 23, 2016), https://perma.cc/PD99-J49A. The general strategy had been to purchase credit protection on a variety of companies and indexes. The outsized growth of these positions, their illiquidity, and the sudden change in underlying economic conditions all contributed to the losses.

3 *See generally* STAFF OF THE PERMANENT SUBCOMM. ON INVESTIGATIONS, S. HOMELAND SEC. & GOV. AFFAIRS COMM., 113TH CONG., JPMORGAN CHASE WHALE TRADES: A CASE HISTORY OF DERIVATIVES RISKS AND ABUSES (2013), https://perma.cc/D2EX-Z24S.

4 *See* In re JPMorgan Chase & Co., Federal Reserve Docket No. 13-001-B-HC (Jan. 14, 2013) (consent order), https://perma.cc/9NZT-XPDF; *see also* In re JPMorgan Chase & Co., Federal Reserve Docket No. 13-031-CMP-HC (Sept. 18, 2013) (assessment order), https://perma.cc/L6BW-6FMW.

5 *See, e.g.*, David Benoit, *J.P. Morgan's Whale of a Volcker Question*, WALL ST. J. (Mar. 15, 2013), https://perma.cc/5H3J-MWWS; *see also* Suzy Khimm, *Paul Volcker vs. JPMorgan's London Whale*, WASH. POST (May 11, 2012), https://perma.cc/MEU2-GU2N; *see also* Michael A. Santoro, *Would Better Regulations Have Prevented the London Whale Trades?*, THE NEW YORKER (Aug. 21, 2013), https://perma.cc/35PG-VG9N.

clarity about the appropriate allocation of supervisory responsibility over international financial conglomerates, as well as difficulties in sharing examination information between regulators.[6] The role of Whitefriars, a subsidiary established under a law known as the Edge Act, was largely absent from the policy debate that resulted from the London Whale.[7]

Rather than interpreting the episode as a cautionary tale that signaled a need to reform an antiquated U.S. banking law, observers largely glossed over the role in it of a specific type of international subsidiary of international banking conglomerates. As a result, an opportunity to reexamine the risks and benefits of an archaic—but nonetheless significant—banking law was missed. This Article attempts such a re-examination and argues that we will remain vulnerable to more London Whale-type events if the status quo persists.

The evolution of the Edge Act, from its origin as a law meant to encourage U.S. trade and exports to its central role in a scandal involving complex structured securities, is both important and underappreciated. Notwithstanding the fact that, according to one leading banking law textbook, the Edge Act "continues to be surprisingly relevant today,"[8] there is a dearth of contemporary scholarship documenting the role of Edge Act Corporations (EACs) and their implications for modern banking law and policy.[9] The Edge Act should not be overlooked any longer, as it

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6 *See* OFC. OF INSPECTOR GEN., THE BOARD SHOULD ENHANCE ITS SUPERVISORY PROCESSES AS A RESULT OF LESSONS LEARNED FROM THE FEDERAL RESERVE'S SUPERVISION OF JPMORGAN CHASE & COMPANY'S CHIEF INVESTMENT OFFICE 47–48 (2014), https://perma.cc/H8NM-H5GS.

7 For example, the Edge Act is scarcely mentioned in the more than 3,000 pages of the Senate report and hearing transcripts dissecting the episode, with the exception of a few passing references in the prepared statement of the Comptroller of the Currency. *See JPMorgan Chase Whale Trades: A Case History of Derivatives Risks and Abuses: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Security,* 103d Cong. 147–48 (2013), https://perma.cc/VN6M-BRCL.

8 MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, FINANCIAL REGULATION: LAW AND POLICY 750 (1st ed. 2016).

9 Most of the recent legal actions and scholarship regarding the Edge Act has focused on the scope and applicability of section 632, added by section 25 of the Banking Act of 1933, *see* Banking Act of 1933, Pub. L. No. 73-66, § 15, 48 Stat. 162, 184 (1933), which provides access to Federal courts in the U.S. for claims against U.S. banks. *See, e.g.*, Highland Crusader Offshore Partners, L.P. v. Lifecare Holdings, Inc., 627 F. Supp. 2d 730 (N.D. Tex. 2008); *see also* Steven M. Davidoff, *Section 632: An Expanded Basis of Federal Jurisdiction for National Banks*, 123 BANKING L.J. 687 (2006); Elizabeth R. Sheyn, *The (Un)Constitutionality of Section 632 of the Edge Act: An Analysis under Article III and Theories of Protective Jurisdiction*, 41 LOY. U. CHI. L.J. 587 (2010). In the wake of the financial crisis of 2008, foreign investors in risky mortgage-related securities, structured financial products, and other instruments availed themselves of section 632 to bring

serves as a valuable case study to enrich the picture of the role of U.S. banks in the global economy.[10]

While not a full account of U.S. banking activities abroad, the esoteric Edge Act offers a lens through which to observe the evolution of financial law and policymaking and the political economy of finance. EACs are overseas "nonbank-banks," legal anomalies permitted to engage in a wide range of financial intermediation while enjoying exclusions or exemptions from the requirements and protections traditionally applied to banks. This arrangement exposes the domestic financial system to risk and complexity in the name of international expansion. Yet, the Edge Act is a lacuna in U.S. banking law that receives little scrutiny relative to the other forms of nonbank-bank.[11]

The Edge Act provides a case study for evaluating the claim that deregulation-driven "competitiveness" provides a boon to the nonfinancial economy through the financing of trade.[12] Such was

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claims against U.S banks that had sold them such products. *See* Am. Int'l Gp., Inc. v. Bank Am. Corp., 820 F. Supp. 2d 555 (S.D.N.Y. 2011); *see also* Dexia SA/NV v. Bear, Stearns & Co., 924 F. Supp. 2d 555 (S.D.N.Y. 2013).

While post-crisis scholarship has examined the international actions of U.S. financial policymakers, *see*, *e.g.*, Peter Conti-Brown & David Zaring, *The Foreign Affairs of the Federal Reserve*, 44 J. CORP. L. 665 (2019), and the role of foreign banks' activities within the U.S., *see* Jeremy C. Kress, *Domesticating Foreign Finance*, 73 FLA. L. REV. 951 (2021), legal academic literature has often overlooked the international role of U.S. banks. *See* Frederick R. Dahl, *International Operations of U.S. Banks: Growth and Public Policy Implications*, 32 LAW & CONTEMP. PROBS. 100, 101 (1967) (noting that the "impact of domestic banks' international operations on the structure and functioning of the banking system has . . . received little in the way of comprehensive and critical scrutiny"); *but see* DANIEL K. TARULLO, BANKING ON BASEL: THE FUTURE OF INTERNATIONAL FINANCIAL REGULATION (2008).

10 While this Article focuses on financial regulation, the involvement of international banks in purportedly nonfinancial, expressly political, issues of U.S. foreign policy has a long and sordid history. *See*, *e.g.*, Selam Gebrekidan, et al., *Invade Haiti, Wall Street Urged. The U.S. Obliged*, N.Y. TIMES (May 20, 2022), https://perma.cc/XAA6-YVBY (documenting the role of National City Bank in the U.S. invasion of Haiti in 1915); *see also* David D. Kirkpatrick, *How a Chase Bank Chairman Helped the Deposed Shah of Iran Enter the U.S.*, N.Y. TIMES (Dec. 29, 2019), https://perma.cc/PX86-387E .

11 *See*, *e.g.*, Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN. L. REV. 1539 (2007) (examining the evolution of, and policy issues surrounding, industrial loan companies (ILCs)). EACs differ from ILCs because the latter corporate form allows commercial firms to engage in lightly regulated banking, while the former allows deregulated banking and commercial activity within the bank holding company structure, especially the largest U.S. bank holding companies.

12 *See* U.S. DEPT. OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS 54–56 (2017) ("U.S. implementation of certain international standards in a manner more stringent than the international standard can make U.S. institutions less competitive globally . . . U.S. regulatory requirements that exceed the applicable international standard can sometimes create an undue burden of higher costs to our economy, and risk making U.S. firms less competitive internationally.").

the justification offered in favor of the effective repeal of New Deal legal separations between banking and securities,[13] and against more stringent regulation of the financial services sector in the wake of the Global Financial Crisis of 2008 (GFC).[14] In the earliest days of his presidency, Donald J. Trump issued an Executive Order declaring "core principles" for his administration's approach to financial regulation, one of which included "enabl[ing] American companies to be competitive with foreign firms in domestic and foreign markets."[15] In an otherwise anomalous presidency, this was an orthodox approach to financial regulation.[16]

The notion of "international competition" is premised upon a variety of assumptions: that large nonfinancial corporations will only be able to engage in international trade if there are giant international financial institutions; that having a larger financial system provides a net benefit to national economies; and, frequently, that U.S. banks are on the precipice of ceding their world dominance. The argument exists in a perpetual and delicate balance: the U.S. has the greatest markets and institutions in the world, but its success is always on the verge of being squandered as a result of regulatory overreach. More often than not, deregulation is the proffered means of preserving the competitive advantage of U.S. banking.[17]

Within this context, the following examination reveals that the justifications for the *sui generis* legal status of EACs are premised upon misplaced notions of international competition and trade. The Edge Act began as a means to promote the competitiveness of U.S. banks abroad in the service of U.S.

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13 *See infra* notes 212–17 and accompanying text.

14 *See infra* note 292 and accompanying text.

15 Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017). This order was subsequently revoked by President Biden. Exec. Order No. 14,018, 86 Fed. Reg. 11855 (Mar. 1, 2021).

16 *See, e.g.*, NAT'L ECON. COUNCIL, A FRAMEWORK FOR FINTECH 7 (2017) (arguing that, for the "U.S. financial system to remain competitive in the global economy" required "supporting U.S.-based fintech companies in exporting their products and services"); *see also* Jonathan R. Macey & James P. Holdcroft Jr., *Failure is an Option: An Ersatz-Antitrust Approach to Financial Regulation*, 120 YALE L.J. 1368, 1413 (2011) (observing that throughout the 1980s and 1990s, U.S. financial regulators "favored expanding the powers of U.S. banks, particularly in the area of underwriting corporate securities, because the international competitiveness of large U.S. banks was threatened").

17 The U.S. has not been alone in this project. For example, the U.K. prioritized international competition during its "Big Bang" deregulation in the 1980s. *See infra* note 204. It has returned to that approach by calling on its financial regulators to focus on competitiveness in the wake of Brexit, to the objection of its chief banking regulator, the Bank of England. *See* Huw Jones, *Britain Piles Pressure on Regulators to Keep Finance Competitive After Brexit*, REUTERS (Nov. 9. 2021), https://perma.cc/B9Q4-AYM4.

manufacturing and commerce. As the financial sector has become increasingly volatile and self-referential, however, the Edge Act has come to prioritize banking as an end in itself. As a result, the tool of private financial sector deregulation and credit has proven to be an ineffective means of bolstering exports and the industries involved in producing them, such as manufacturing and agriculture. The original purpose of this century-old law has become an anachronism. The experience of the Edge Act should cause legislators and policymakers to treat such claims about the value of financial sector deregulation and international competitiveness with greater skepticism.

This Article proceeds to examine the Edge Act and its implications for international finance in the following sections. Section II recounts the legislative history of the Edge Act and U.S. banks' early forays into overseas financing, which proceeded in fits and starts. Section II also describes the subsequent growing pains experienced during the post-World War II banking expansion, including a renewed push for bank deregulation and the risks associated with the newfound adventurism of U.S. banks. Section III revisits the era of so-called "financial modernization," including its roots in U.S. competitiveness, the GFC and its aftermath, and current examples of systemically important financial companies' uses of the Edge Act. Section IV explores areas in which the lessons gleaned from examining the Edge Act can be applied to current and future policymaking. This includes the traditional separations of banking entities from nonbanking financial and commercial businesses, attempts to impose activity constraints upon banking entities, the mechanics of cross-border resolution of international banking conglomerates, and the oversight of digital assets and payment systems. Before concluding, this Article considers potential reforms to the Edge Act and its implementing regulations.

These insights are likely to be of continued relevance with the emergence of digital banking and digital assets that have challenged the spatial and conceptual borders of the financial markets. The trend toward digitization has led to a resurgence of the nonbank-bank model and a revival of arguments promoting international competitiveness.[18] In this context, the role of EACs within the corporate structure of modern financial conglomerates presents a cautionary tale of how private market "innovations," in the form of piecemeal deregulation unaccompanied by

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[18] *See infra* Part IV.A.1.

proportional regulatory adjustments, leave the financial system exposed to unforeseen and underappreciated vulnerabilities.

These lessons are relevant once again in the wake of the Russian invasion of Ukraine. The international response has relied upon economic and financial sanctions transmitted through U.S. banks with global footprints.[19] Banks' direct exposures to the Russian economy have resulted in a reduction in their market capitalizations as well as their capital ratios.[20] Global banks have also been indirectly exposed—including through their investment banking, wealth management, derivatives, and commodity financing businesses—in ways that are "difficult to identify and assess" with the potential to be "meaningful and surprise investors once revealed."[21] Global U.S. banks are vulnerable to cyber and other operational risks that could result from an attack on their information technology infrastructure in response to broader geopolitical events.[22] Finally, political economists have begun to examine the interactions between international banks' geopolitical importance and their domestic political power.[23] While all of the concerns highlighted in this Article may not come to fruition, its contributions should help scholars and policymakers to better appreciate the risks to domestic economies posed by globalized banking.

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[19] *See* Stephen Morris & Owen Walker, *Banks and Russia: There is No Easy Way Out*, FIN. TIMES, (Mar. 18, 2022), https://perma.cc/ZS48-DBY2; *see also* Sanne Wass, *Sanctions Against Russia May Prompt Iran-style De-risking by Banks*, S&P GLOBAL MKT. INTELL. (Mar. 3, 2022), https://perma.cc/YV6C-5Q3S.

[20] *See* IMF, *Shockwaves from the War in Ukraine Test the Financial System's Resilience* Global Financial Stability Report at 13 (Apr. 2022) (direct exposures to Russia caused US banks' market capitalization to decline by 8% on average, and limiting or exiting their Russian operations will reduce banks' equity capital ratios by an estimated 20 to 80 basis points).

[21] *Id.*; *see also id.* at 18–22 (discussing some of the potential impacts on dealer banks from disruptions in commodities and short-term funding markets); *see also* OFF. OF THE COMPTROLLER OF THE CURRENCY, SEMIANNUAL RISK PERSPECTIVES 11 (Spring 2022) ("Russia's invasion of Ukraine in early 2022 introduced broad implications for commodity prices, inflation, and the Federal Reserve's path to normalizing interest rates and combating sustained higher price growth. For U.S. banks, although the direct exposure to Russia and Ukraine is limited ($15.8 billion as of December 31, 2021), indirect risks are broad and enforcement of sanctions that have been imposed by various countries will likely strain banks' compliance resources.").

[22] *See* IMF, *supra* note 20, at 22.

[23] *See* Elsa Clara Massoc, *Banks' Structural Power and States' Choices on What Structurally Matters: The Geo-Economic Foundations of State Priority toward Banking in France, Germany, and Spain*, 50 POL. & SOC'Y 599, 616 (2022).

II. WHERE WE WERE: THE ERA OF PRIVATIZATION

U.S. financial institutions were enlisted to help execute World War I. The Federal Reserve (Fed), the nation's central bank, "recognized its duty to cooperate unreservedly with the Government to provide funds needed for the war and freely conceded that the great national emergency made it necessary to suspend the application of well-recognized principles of economics and finance which usually govern banking operations in times of peace."[24] Unusual measures, including an aggressive expansion of credit, were required because "[w]ar is the most uneconomic of all processes."[25] The Fed was not alone. Private banks helped the U.S. Treasury raise debt and supported European allies in managing their war production and monetary systems.[26]

By the end of the war, many European countries were in a precarious financial situation due to factors that included the decimation of national infrastructure during the war, the debt overhang from war financing, and the toll of German reparations payments.[27] The U.S. had loaned a great deal of money to its European allies, and made debt repayment a priority at Versailles.[28] All of these factors contributed to the passage of new legislation to boost U.S. exports and trade by leveraging the private banking system.

A. The Edge Act's Origins

Until the passage of the Federal Reserve Act (FRA) in 1913, national banks could not establish overseas branches or accept

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[24] BD. OF GOVERNORS OF THE FED. RSRV. SYS., SEVENTH ANNUAL REPORT 11 (1921). Prior to the Banking Act of 1935, there was a closer relationship between the central bank and the treasury, with the Treasury Secretary serving as the chair of the Federal Reserve's board and the Comptroller of the Currency as the vice chair. *See* Richard H. Timberlake, Jr., *Institutional Evolution of Federal Reserve Hegemony*, 5 CATO J. 743, 752 (1986).

[25] BD. OF GOVERNORS OF THE FED. RSRV. SYS., *supra* note 24, at 11.

[26] *See* Securities Industry Ass'n v. Bd. of Governors of the Fed. Rsrv. Sys., 839 F.2d 47, 60 (2d Cir. 1988) ("Many banks formed security affiliates in order to handle the sale of government bonds used to finance World War I. Banks were 'expected' to aid the government in distributing war loans and were 'encouraged' to aid potential investors by lending them the purchase price of government bonds." (citations omitted)); *see also* RON CHERNOW, THE HOUSE OF MORGAN: AN AMERICAN BANKING DYNASTY AND THE RISE OF MODERN FINANCE 183–204 (paperback ed. 2010); ARTHUR E. WILMARTH, JR., TAMING THE MEGABANKS: WHY WE NEED A NEW GLASS-STEAGALL ACT 19–22 (2020); ZACHARY D. CARTER, THE PRICE OF PEACE: MONEY, DEMOCRACY, AND THE LIFE OF JOHN MAYNARD KEYNES 48–52 (First ed. 2020). U.S. banks had such a stake in the outcome of the Treaty of Versailles that J.P. Morgan executive Thomas Lamont was included in its negotiations. *See* CHERNOW, *supra*, at 207–09.

[27] *See* CARTER, *supra* note 26, at 69–82.

[28] *See id.* at 61–88.

drafts.[29] Before the war, trade credit was only needed to smooth seasonal imbalances. In the postwar period, European nations' rebuilding effort required them to import materials, and the typically short-term—60- or 90-day—credits used to finance trade during seasonal imbalances were not fit for purpose.[30] The FRA addressed this by allowing national banks to establish branches abroad.[31] A 1916 FRA amendment created "Agreement Corporations" (ACs), state-chartered banks authorized to operate abroad pursuant to a written agreement with the Fed.[32]

By 1919, the year of the Versailles Treaty, Congress was concerned that the U.S. had "been loaning enormous sums, or credits, to these countries for the purchase chiefly of foodstuffs, and Congress had authorized the War Finance Corporation to advance a round billion dollars for financing export trade."[33] It decided that "Government advances should stop and that the business should be financed by private capital."[34] Rather than focusing on the underlying foreign policy issues that created this precarious situation, such as the treaty's onerous and austere economic implications, policymakers identified two of its symptoms: (1) the exchange rate disparities between the creditor U.S. and debtor European countries; and (2) U.S. banks' constraints against providing trade credit.[35] The latter factor inspired the Edge Act.

1. Credit as a Postwar Panacea

The Edge Act's proponents argued that the U.S. had extended too much public support to its World War I allies, and that European countries should "put their houses in order" and stop asking for debt forgiveness.[36] The solution to the European economic malaise was for the U.S. to become a full-fledged "creditor nation,"

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29 *See* Dahl, *supra* note 9, at 102.

30 *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., *supra* note 24, at 20–21.

31 *See* 12 U.S.C. § 601 (1948). U.S. banks are permitted to establish branches abroad "for the furtherance of the foreign commerce of the United States, and to act if required to do so as fiscal agents of the United States." *Id.*

32 *See* H. REP. NO. 66-408, at 1–2 (1919).

33 *Id.*

34 *Id.* at 2; *see also* Thomas C. Baxter, Jr. & James H. Freis, Jr., *Fostering Competition in Financial Services: From Domestic Supervision to Global Standards*, 34 NEW ENGL. L. REV. 57 (1999) ("The Edge Act was enacted after the First World War to encourage the flow of private capital (as opposed to direct U.S. government outlays) to help rebuild wartorn Europe.").

35 *See* GUARANTY TR. CO. OF N.Y., FOREIGN FINANCING UNDER THE EDGE ACT 1–2 (1919).

36 59 CONG. REC. 51 (1919) (remarks of Rep. Wingo).

with private banks, rather than the Treasury, playing a central role in facilitating U.S. exports.[37]

Senator Walter Evans Edge of New Jersey argued that U.S. banks could play an important role in postwar trade and economic development, through the creation of corporate subsidiaries that could act as intermediaries between U.S. sellers and foreign buyers:

> The American exporter or manufacturer may sell his goods to an impoverished foreign purchaser—a foreign government or a private concern. One of the proposed corporations then may accept collateral from the purchaser, acceptable to the Federal Reserve Board, and against this issue debentures to sell to investors, and the money so received will be paid to the American seller. Through the powers granted to these proposed corporations they may accept even mortgages on the plants or other real property of the purchasers . . . Thus a foreign concern in need of raw material may obtain it by giving a mortgage on its plant, and eventually by turning this raw material into finished product will be able to redeem its collateral and to put aside a little profit besides.[38]

According to one Fed official, there was "no one way in which the present European credit situation may be more effectively dealt with than by the incorporation of institutions of the kinds provided for" in the Edge Act.[39] And "anything that betters that

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[37] *See* S. REP. NO. 66-108, at 2 (1919); *see also* 59 CONG. REC. 51 (1919) (remarks of Rep. Wingo) ("Congress, by the enactment of this foreign finance bill, serves notice upon the world that whatever aid America gives to the peoples of the allied countries in the future will not come from the United States Treasury, but such aid must come alone through the private corporations authorized to be created by this bill, which provides a machinery for meeting all the legitimate demands of Europe for financial aid upon business terms for the rehabilitation of her devastated lands and her destroyed industries."); WALTER EVANS EDGE, A JERSEYMAN'S JOURNAL: FIFTY YEARS OF AMERICAN BUSINESS AND POLITICS 114 (1948) ("The fundamental purpose of this act was to provide easier credit for foreign purchase of American goods. Shortly after the close of World War I, all Europe wanted American products but did not have the ready cash in dollar credits. . . . At that time our object was to give the financially prostrate European nations long-term credits when we knew they could not give us dollars."); J.J. McGuire, *The Edge Act: Its Place in the Evolution of International Banking in the United States*, 3 U. MIAMI INTER-AM. L. REV. 427, 431–33 (1971); JOINT ECON. COMM., THE FEDERAL RESERVE SYSTEM 166–67 (1977) ("When his act was passed, the United States was a creditor nation, and Europe was broke. Senator Edge proposed that these corporations be set up to finance European imports from the United States by buying European bills, rolling them over, and redeeming them as the economies of Europe began recovering.").

[38] GUARANTY TR. CO. OF N.Y., *supra* note 35, at 6–7 (quoting Senator Edge).

[39] S. REP. NO. 66-108, at 3 (quoting Federal Reserve Board Governor William P.G. Harding).

situation assists not merely in the gigantic task of reconstruction in Europe, but also in providing a market for our own exports and in developing our foreign commerce in a most effective and satisfactory way."[40]

Legislators spoke about the Edge Act in similar terms:

> A very large part of our prosperity as a nation now depends upon foreign trade, upon holding and extending foreign markets for our surplus products. If our export trade should collapse because of the utter inability of our chief customers to pay in cash or by the usual terms of drafts and bills of exchange the consequences would be disastrous to many of our industries. If on the other hand the passage of this bill . . . results in a certain measure of ownership of foreign transportation or industrial agencies we shall be but reinvesting in Europe, the capital which the people of the older countries formerly invested in our railroads and industries at a time when we of the United States needed capital. In a word, we shall have become in our turn a creditor Nation, having purchased securities that will bring us a continued income with a part of our surplus of commodities.[41]

Named after its sponsor, the Edge Act had three purposes: (1) encouraging U.S. banks to finance exports; (2) promoting international and domestic competition—namely, helping regional U.S. banks compete with foreign banks and challenge an international banking monopoly;[42] and (3) enhancing Federal oversight of U.S. banks' international operations.[43] It framed financial deregulation as the solution to an array of economic and geopolitical

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[40] *Id.*

[41] H. REP. NO. 66-408, at 4 (1919).

[42] Prior to its enactment, there was one national bank operating abroad, National City Bank, which had 70 branches around the world, and eight state-chartered banks operating ACs abroad. *See* S. REP. No. 66-108, at 2–3. National City was operating abroad through foreign branches authorized by section 25 of the FRA. *See id.* at 1. For further discussion of foreign branches see *infra* Section IV.A.5.

[43] *See* S. REP. NO. 66-108, at 3–4 (1919); *see also* S. REP. No. 95-1073, at 3–4 (1978). During the floor debate on the conference report, lawmakers framed the Edge Act in antimonopoly terms, in particular arguing that it was needed to give smaller institutions the ability to compete with the J.P. Morgan banking dynasty. *See* 59 CONG. REC. 50 (1919) (remarks of Rep. Platt) ("We do not want to hamper the institutions to be incorporated under this section so that they will be unable to compete with great private banks like J.P. Morgan & Co., Lee, Higginson & Co., who are not hampered . . . . We have put in restrictions against monopoly and any practice that could be deemed against good banking and good finance.").

problems.[44] Like most financial deregulation, it was presented as a win-win proposition: freeing U.S. banks from their constraints abroad would shift the burden of solving Europe's economic problems from the public to the private sector.[45] Credit would fill the gap for the lackluster macroeconomic situation. The profits would accrue to the U.S. manufacturing and finance industries. This arrangement would benefit "real economy" businesses like manufacturers, farmers, and ranchers.[46] The fate of the U.S. financial system, and the wellbeing of the nation as a whole, was at stake.[47]

2. Creating Overseas Nonbank-Banks

The Edge Act added section 25A to the FRA, authorizing the creation of EACs as corporate subsidiaries of national banks with a special charter from the Fed to "engag[e] in international or foreign banking or other international or foreign financial operations" without complying with state-by-state banking laws.[48] EACs could, pursuant to regulations promulgated by the Fed, engage in nine different financing activities, including some limited deposit taking.[49] EACs could establish branches or agencies

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44 At one point during the floor debate, a member of the House of Representatives argued that the law's only "danger is . . . that we may have put in too many restrictions rather than too few." 59 Cong. Rec. 50 (1919) (remarks of Rep. Platt).

45 Far from being wholly private enterprises, however, EACs have been particular beneficiaries of governmental support. *See infra* Section I.C.2.

46 *See* H. REP. NO. 66-408, at 3.

47 *See* 109 COMMERCIAL AND FINANCIAL CHRONICLE 732 (Aug. 23, 2019) (statement of Senator Robert Owen to the Senate Committee on Banking and Currency) ("If this is not done, I warn this Committee . . . we are going to meet with an obstruction to our foreign commerce that [would bring] the most injurious consequences upon the people of the United States, upon the home markets, and upon all sorts of stocks and securities."); *see also* Paul P. Abrahams, *American Bankers and the Economic Tactics of Peace: 1919*, 56 J. AM. HIS. 572, 578 (1969).

48 Edge Act, Pub. L. No. 66-106, 41 Stat. 378, 378 (1919) (codified at 12 U.S.C. § 611).

49 EACs could: (1) "purchase, sell, discount, and negotiate, with or without its [e]ndorsement or guaranty, notes, drafts, checks, bills of exchange, acceptances, including bankers' acceptances, cable transfers, and other evidences of indebtedness;" (2) "purchase and sell, with or without its [e]ndorsement or guaranty, securities, including the obligations of the United States or of any State thereof but not including shares of stock in any corporation except as herein provided;" (3) "accept bills or drafts drawn upon it subject to any limitations and restrictions as the [Fed] may impose;" (4) "issue letters of credit;" (5) "purchase and sell coin, bullion, and exchange;" (6) "borrow and lend money;" (7) "issue debentures, bonds, and promissory notes subject to any Fed-imposed conditions and limitations, not to exceed 10 times an EAC's capital; (8) take deposits outside of the U.S. and take U.S. deposits so long as they are "incidental to or for the purpose of carrying out transactions" in foreign countries and the EAC maintained reserves equal to 10 percent of U.S. deposits; and (9) "generally to exercise such powers as are incidental" to the authorized powers, or as the Fed determines "may be usual . . . in connection with the transaction of the business of banking or other financial operations" in the foreign countries in which

abroad, subject to Fed approval and any relevant terms and conditions.[50] An EAC's ability to operate inside the U.S. was limited to activities that the Fed determined were "incidental to its international or foreign business."[51]

While early drafts had limited EACs to banking, the Fed argued that allowing EACs to engage in other "financial activities" was essential to achieving the goal of boosting exports.[52] The Edge Act created two types of entities: (1) banking EACs that engage in limited deposit taking, lending, and related activities; and (2) investment EACs in which a U.S. bank directly owns shares in foreign companies.[53] Because EACs were "not to be banks of deposit," Congress determined that they did not require traditional banking protections.[54]

Departing from the longstanding principle of separating banking from commerce,[55] EACs were permitted to invest in nonfinancial companies, so long as the companies' U.S. business was only "incidental to its international or foreign business."[56] This authority was intended to allow banks to invest in joint ventures with nonfinancial companies, bringing their financing expertise to the realm of trade.[57] At the same time, EACs were prohibited from otherwise "engag[ing] in commerce" or directly trading commodities, and EACs and their officers and directors were prohibited from controlling or fixing the price of commodities or conspiring to use the EAC's financial resources to do so.[58] In tension with EACs' ability to own nonfinancial businesses, Congress was concerned that, consistent with broader concerns about mixing banking and commerce, allowing EACs to own and trade in commodities would create monopolies that engage in anticompetitive practices like driving up prices or tying the purchase of raw materials to credit products.[59]

the EACs operate, so long as they are "not inconsistent with the powers specifically granted" by the Edge Act, Pub. L. No. 66-106, 41 Stat. 378, 379–80 (1919) (codified at 12 U.S.C. § 615(a)).

50 *See id.* at 380 (codified at 12 U.S.C. § 615(b)).

51 *Id.* at 381 (codified at 12 U.S.C. § 616).

52 *See* S. REP. NO. 66-108, at 2–3.

53 H. REP. No. 66-408, at 3.

54 *Id.*

55 *See, e.g.,* Wilmarth, *supra* note 11, at 1554–87.

56 Edge Act, Pub. L. No. 66-106, 41 Stat. 378, 380 (1919) (codified at 12 U.S.C. § 615(c)). Such investment could not exceed 10% of the capital of investment EACs and 15% of the capital of banking EACs. *See id.*

57 *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., *supra* note 24, at 21.

58 *See* Edge Act, Pub. L. No. 66-106, 41 Stat. 378, 381 (1919) (codified at 12 U.S.C. § 617).

59 *See* 59 Cong. Rec. 50–51 (1919) (remarks of Rep. Wingo).

EACs were subjected to several other limitations. To ensure their solvency, they needed a minimum of $2 million in total capital at the time of incorporation, and national banks could not invest more than 10 percent of their capital in EAC stock.[60] Directors of EACs were required to be U.S. citizens, and the majority of investors in an EAC were required to be U.S. citizens or corporations.[61] At the same time, EACs' officers, directors, and employees were exempt from the management interlocks prohibitions of the Clayton Antitrust Act of 1914, permitting them to serve at both an investing bank and its investee EAC.[62] EACs were also restricted from buying stock in EACs or ACs that were in "substantial competition."[63]

The Edge Act highlights the complexity, and resulting tensions, of financial policymaking throughout the 20th century.[64] Policymakers argued that nonfinancial industries were best served by policies limiting banks' activities and constraining their economic power.[65] At the same time, they believed customers and the economy would benefit from policies that promote financial "competitiveness" by allowing banks to engage in a wide range of financial activity.[66] Reconciling these conflicting policies has been a recurring challenge in international and domestic banking law.

B. The Uneven Early Years of International Banking

The Fed issued the first rules governing U.S. banks' international activities, Regulation K, in 1920. Regulation K included procedures for EACs and ACs to establish foreign branches, engage in international banking, and invest in foreign organizations.[67]

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60 *See* Edge Act, Pub. L. No. 66-106, 41 Stat. 378, 381 (1919).

61 *See id.* at 379, 381.

62 *See id.* at 381. To this day, EACs are still exempt from the prohibition against management interlocks. *See* 12 C.F.R. § 26.4(b).

63 *See* Edge Act, Pub. L. No. 66-106, 41 Stat. 378, 380 (1919) (codified at 12 U.S.C. § 615(c)).

64 *See* Michael Gruson, *Investment in Foreign Equity Securities and Debt-Equity Conversion by U.S. Banks, Bank Holding Companies, and Foreign Bank Holding Companies*, 1988 COLUM. BUS. L. REV. 441, 442 (1988) ("A tension arises when U.S. banks and bank holding companies engage in activities abroad . . . . U.S. legislators and regulatory agencies have carefully balanced these competing interests. The result is a highly complex set of rules.").

65 *See id.* at 441.

66 *See id.* at 441–42.

67 *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., *supra* note 24, at 25–26. The Fed would amend Regulation K 13 times between 1920 and 1970. *See* McGuire, *supra* note 37, at 434.

There was some initial, but modest, growth in U.S. banks' international activities in the postwar European reconstruction period, with three EACs formed in the 1920s. The Federal International Banking Company was a consortium of a thousand commercial banks, with a home office in New Orleans. It was established to finance trade in tobacco, lumber, and, most importantly, cotton.[68] The First Federal Foreign Banking Association was organized by eleven commercial banks to finance foreign trade, and the First Federal Foreign Banking Corporation operated subsidiaries in Argentina, Brazil, and Switzerland, and offices in several other countries.[69]

In 1929, a consortium of aspiring bankers challenged the Fed's denial of their application to form their EAC, the Foreign Financing Corporation.[70] The Fed had determined that the applicants lacked the "qualifications reasonably necessary to assure the financial soundness, reliable and competent management, or the proper or successful operations of a corporation organized under [the Edge Act] to engage in the highly technical activities of international or foreign banking or other international or foreign financial operations and that it would be detrimental to the public interest to approve" their application.[71] In *Apfel v. Mellon*, the court concluded that "Congress was providing a means for conferring special and important privileges upon such corporations as should be organized under the Edge Act" and that "abuse by any corporation of the powers thus granted to it might involve grave consequences to our public service."[72] It was therefore "reasonable to believe that Congress intended that a careful investigation should be made by the [Fed] concerning the character and competency of the incorporators of such an enterprise, as one of the means of determining whether to grant or withhold their approval of the application for incorporation."[73] Not only did EACs have latitude to operate internationally, but the Fed enjoyed discretion in determining the scope and fitness of EACs' operations.[74]

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68 *See* McGuire, *supra* note 37, at 436.

69 *See id.*

70 *See* Apfel v. Mellon, 33 F.2d 805 (App. D.C. 1929).

71 *Id.* at 806.

72 *Id.* at 807.

73 *Id.*

74 Separately, the Fed has authority to issue interpretative opinions regarding Regulation K at the request of any person. *See* 12 C.F.R. § 211.11.

By 1932, twenty EACs and ACs had been chartered.[75] After the enactment of the Edge Act, large U.S. banks underwrote and marketed syndicated loans to the German government, as well as bonds issued by European governments and corporations, and by Latin American countries.[76] Nonetheless, financial deregulation could not fix the economic and political problems created by the debt overhang from World War I. As a result, economic growth remained weak while the political status quo grew increasingly unstable.[77] Federal International Banking Company and First Federal Foreign Banking Association were liquidated in 1925, and the third, First Federal Foreign Banking Corporation, was liquidated in 1933.[78]

1. The Great Depression and the Glass-Steagall Act

U.S. export financing tapered off and came to a virtual standstill during the stock market crash and the ensuing Great Depression. In the wake of that banking panic, Congress passed the Banking Act of 1933, commonly known as the Glass-Steagall Act, separating commercial banking from investment banking.[79] The Banking Act added a new section 23A to the FRA limiting transactions between banks and their nonbank affiliates.[80] The Banking Act also gave the Fed authority to limit the interest rate that banks could pay to attract time and savings deposits, and prohibited paying interest on demand deposits.[81]

Glass-Steagall was meant to prevent banks from using public-backed funds for speculative activities and limit the associated risks.[82] Its sponsors argued that the "banking system was diverted from its original purposes into investment activities" and narrowing banks' focus would "call back to the service of agriculture and commerce and industry the bank credit and the bank

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75 *See* Neil Pinsky, *Edge Act and Agreement Corporations: Mediums for International Banking*, 4 ECON. PERSP. 28 (1978).

76 For an extensive history of large U.S. commercial banks' postwar activities in Europe and Latin America, see WILMARTH, *supra* note 26, at 50–69.

77 *See, e.g.*, CARTER, *supra* note 26, at 136–44, 176–245. Among other contributing factors, over-indebtedness to U.S. banks caused a German banking crisis in 1931. *See* S. REP. NO. 73-77, at 5 (1933).

78 *See* McGuire, *supra* note 37, at 436.

79 *See* Banking Act of 1933, Pub. L. 73-66, 48 Stat. 162 (1933).

80 *See* Veryl Victoria Miles, *Banking Affiliate Regulation Under Section 23A of the Federal Reserve Act*, 105 BANK. L.J. 476, 480 (1988).

81 *See* Banking Act of 1933, Pub. L. 73-66, § 11, 48 Stat. 162 (1933). The Fed implemented these restrictions through its Regulation Q. *See* Prohibition Against Payment of Interest on Demand Deposits, 76 Fed. Reg. 42015, 42015 (July 18, 2011).

82 *See* S. REP. NO. 73-77, at 9–10.

service designed by the framers of the [FRA]."[83] Among their examples, they cited large banks' marketing of risky foreign bonds through their securities businesses.[84]

Yet, neither Glass-Steagall's structural separations nor section 23A's affiliate transaction restrictions applied to EACs.[85] U.S. banks' international activities were exempted from rules meant to limit banks' activities, again ostensibly in the name of "competitiveness."

2. The Postwar Era

Interest in overseas banking remained stagnant for the next two decades.[86] By 1940, only one EAC remained, owned by Chase National Bank.[87] Just two EACs were chartered between 1932 and 1956.[88] One was Bank of America, which engaged in general foreign banking and, until 1963, operated several foreign branches.[89] The other, American Overseas Finance Corporation, engaged in medium-term financing of purchases of U.S. equipment and services by foreigners, and in foreign lending and investment to finance the establishment and expansion of business abroad.[90]

In contrast to the post-World War I privatization approach codified by the Edge Act, the post-World War II era saw increased public trade financing. Private financing could neither meet the direct need for purchases by European nations rebuilding their economies, nor sustain the U.S. manufacturing sector's wartime expansion.[91] In 1945, Congress codified the government-chartered U.S. Export-Import Bank (EXIM) as an export credit agency for the "purpose of aiding in the financing and facilitating of exports and imports," with the statute noting that Congress intended the

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83 Inv. Co. Inst. v. Camp, 401 U.S. 617, 632 n.29 (1971) (quoting Representative Steagall).

84 *See* WILMARTH, *supra* note 26, at 60–61.

85 *See* Banking Act of 1933, Pub. L. 73-66, 48 Stat. 162, 183 (1933).

86 One of the most noteworthy exceptions to the general trend of retrenchment was J.P. Morgan, which willingly did business with Axis power nations Italy and Japan in the lead-up to World War II. *See* CHERNOW, *supra* note 26, at 279–86, 336–45, 430–68.

87 *See* Fed. Rsrv. Bank of Richmond, *Edge Act Corporations and International Banking*, ECON. Q., June 1967, at 4.

88 *See* Pinsky, *supra* note 75, at 28–29. The number of combined EACs and ACs increased only modestly, from six in 1945 to nine in 1959. *See* Fed. Rsrv. Bank of Richmond, *supra* note 87, at 4.

89 *See* McGuire, *supra* note 37, at 437.

90 *See id.*

91 *See* S. REP. NO. 79-489, at 2 (1945).

bank to "supplement and encourage and not compete with private capital."[92]

The Bretton Woods agreement, reached in 1945 and implemented in 1958, instituted a system of currency convertibility among significant economies with the International Monetary Fund (IMF) as a central multilateral financial institution and the U.S. dollar as the reserve and trading currency.[93] Other notable developments during this time included the creation of the Common Market in Europe, a flow of investment from the U.S. abroad, and an interest by wealthy countries in investing in developing economies.[94]

Throughout this period, U.S. banks used EACs as an international vehicle for arbitraging domestic business restrictions. One example of this was the emergence of the "Eurodollar" market as a significant financing source. The Eurodollar market is the "market for dollar-denominated financial accounts and instruments situated outside of the United States."[95] Eurodollars enabled U.S. banks to more easily serve foreign clients, attracting deposits and certificates of deposit though their international operations, without either (1) running afoul of the capital controls that the U.S. government had instituted in 1965 to address balance of payment issues, or (2) being limited by the Regulation Q prohibition against paying interest on deposits.[96]

In another example, Congress enacted reforms that sought to tighten limits on domestic banking activities and ownership, but preserved the special status enjoyed by EACs' activities abroad. The Bank Holding Company Act of 1956 (BHCA) required Bank Holding Companies (BHCs) to limit their activities and investments to banking, managing or owning banks, or a set of activities that are closely related to banking, as determined by the Fed. The BHCA also required BHCs to limit the trend of banking expansion in circumvention of branching restrictions.[97] Yet entities

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92 Pub. L. No. 79-173, § 2, 59 Stat. 526 (1945). The EXIM Bank had been created by Executive Order in 1934, and was initially funded through the Reconstruction Finance Corporation created during the New Deal. *See* S. REP. NO. 79-489, at 3–4.

93 *See* Fed. Rsrv. Bank of Richmond, *supra* note 87, at 4.

94 *See id.*; *see also* McGuire, *supra* note 37, at 438.

95 Baxter & Freis, *supra* note 34, at 71.

96 *See* Richard K. Abrams, *Regional Banks and International Banking*, 65 ECON. REV. 1, 6–7 (1980); *see also* Dahl, *supra* note 9, at 115 (discussing the interest equalization tax instituted in 1965, as well as the Fed's Voluntary Foreign Credit Restraint program applicable to bank loans to foreign entities).

97 *See* 12 U.S.C. § 1841 *et seq*. All BHCs are required to register with, become subject to consolidated regulation and supervision by, and submit mandatory periodic reports to

organized by U.S. BHCs to operate abroad, including EACs, were excluded from the terms of the BHCA.[98]

Third, banks used EACs to engage in securities activities that were otherwise prohibited by Glass-Steagall. A 1957 revision to Regulation K sought to codify the original intent of the Edge Act by creating two distinct legal entities, the banking Edge and the finance Edge.[99] In doing so, the rule was meant to implement the spirit of Glass-Steagall by separating deposit banking from investment banking.[100] Many of the large New York banks established both types of EAC,[101] and many of the largest banks still retain both a banking EAC and a financial EAC. In addition, while the 1957 Regulation K revision differentiated banking and nonbanking entities, it also liberalized the activities that these entities could engage in, making both types of EACs more attractive as financing vehicles.[102]

In 1963, the Fed further revised Regulation K, walking back its distinction between banking EACs and finance EACs.[103] The rule also codified a statement of "national purpose," that EACs are meant to have "powers sufficiently broad to enable them to compete effectively with similar foreign-owned institutions and to afford to the United States exporter and importer in particular—and to United States commerce, industry, and agriculture in general—at all times a means of financing international trade."[104] Again, the Edge Act sought to ensure the competitiveness of U.S. banks *in the service of* financing international trade and thereby bolster manufacturing, agriculture, and the economy in general. In doing so, EACs had flexibility to conduct a range of activities and use a variety of structures, but were only to engage in activities that were "in the interest of the United States," and practices that were "consistent with high standards of banking or financial prudence" and "clearly related to international or foreign business."[105]

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the Federal Reserve. The Federal Reserve has authority to issue regulations and orders for, and conduct examinations of, BHCs. *See* 12 U.S.C. § 1844.

98 *See* 12 U.S.C. § 1841(c)(2)(G).

99 *See* Dahl, *supra* note 9, at 118–19; *see also* 21 Fed. Reg. 9899, 9900 (Dec. 12, 1956), codified at 12 C.F.R. § 211.4.

100 *See* Dahl, *supra* note 9, at 119.

101 *See id.*

102 *See id.*

103 *See* 28 Fed. Reg. 9421 (Aug. 28, 1963).

104 *Id.* at 9421.

105 *Id.*

EACs developed three primary structures to make foreign investments: (1) wholly owned subsidiaries; (2) controlled subsidiaries with substantial minority investment from a local financial institution; or (3) minority interests in foreign subsidiaries.[106] Large U.S. and European financial institutions could also invest in joint ventures with foreign banks.[107] This latter arrangement complicated the picture of international "competition" by permitting collaboration, as opposed to outright opposition, between ostensible competitor institutions.

U.S. banks continued expanding their activities abroad from 1955 to 1966, with the value of dollar loans and acceptance credits issued to foreign customers growing from $1.75 billion to $9.6 billion, and the number of EACs and ACs growing from seven—three EACs and four ACs—to forty-five, thirty-six of which were EACs, owned by thirty-three banks and BHCs.[108] In terms of geographical dispersion, as of 1964, EACs were making about 40% of their equity investments by dollar value in Europe, with 20% in Latin American countries, 20% in Canada, 10% in Africa, and 5% in Asia.[109]

During this period, banks "began to use London as a center for unregulated deposit taking and lending in dollars."[110] In particular, "eurodollar accounts in Europe offered the basic framework for a largely unregulated global financial market."[111] U.S. banks offered "Eurodollar loan" products, which critics argued were functionally securities products conducted abroad, through EACs, in "subterfuge" of U.S. securities laws.[112] Many of the EACs formed in the 1960s were set up "primarily to engage in the Eurodollar market," clearing funds procured by the parent bank

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106 *See* Dahl, *supra* note 9, at 110–11.

107 For example, the company Ameribas, a joint venture between Bank of America and the French bank Banque de Paris et des Pays-bas, funded by Eurobonds, *see id.*, at 112; NBG Atlantic International Corporation was a joint venture between the U.S. bank Atlantic Bank of New York and the National Bank of Greece, *see* 47 Fed. Reg. 343 (Jan. 6, 1982); Union Chelsea International Corporation was a joint venture between the U.S. bank Union Chelsea National Bank and Venezuelan Banco Union C.A., *see* 46 Fed. Reg. 11363 (Feb. 6, 1981); and Consolidado International Bank, a joint venture between First National Bank of Greater Miami and Venezuelan Banco Consolidado, C.A., *see* 46 Fed. Reg. 56658 (Nov. 18, 1981).

108 *See* Dahl, *supra* note 9, at 103, 109; *see also* Pinsky, *supra* note 75, at 31.

109 *See* George H. Bossy, *Edge Act and Agreement Corporations in International Banking and Finance*, 46 MON. REV. 88, 91 (1964).

110 ADAM TOOZE, CRASHED: HOW A DECADE OF FINANCIAL CRISES CHANGED THE WORLD 80 (1st ed. 2018).

111 *Id.*

112 JOINT ECON. CMTE., *supra* note 37, at 167.

through its branches abroad.[113] U.S. banks using EACs to arbitrage domestic banking restrictions would become a pattern in ensuing decades.

C. The Expansion of International Banking

Subsequent realignment of the international economic order altered the course of U.S. banks' overseas expansion. Bretton Woods formally collapsed in 1973, coinciding with a rise in "petrodollars" and a corresponding demand for unencumbered capital movement.[114] In 1974, the Fed relaxed its capital control rules, freeing U.S. banks' international lending and deposit activities.[115]

Table 1 illustrates the growth of EACs as a vehicle for international finance over the course of almost two decades. From 1956 to 1974, the number of EACs grew more than thirty-five-fold, from three to 107.

Table 1: Growth of Overseas Banking
U.S. EACs, 1956–1974

Year	Number of U.S. EACs
1956	3
1957	4
1958	5
1959	6
1960	10
1961	11
1962	22
1963	30
1964	36
1965	37
1966	40
1967	46
1968	56
1969	63
1970	69

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113 McGuire, *supra* note 37, at 441–42.

114 *See* TOOZE, *supra* note 110, at 80.

115 *See* Norman S. Fieleke, Fed. Rsrv. Bank of Bos., *The Growth of U.S. Banking Abroad: An Analytical Survey*, CONFERENCE SERIES NO. 18, 10 (Oct. 1977).

1971	80
1972	87
1973	98
1974	107

Source: Fed. Rsrv Bank of N.Y., Fed. Rsrv. Bank of Chi., Joint Econ. Comm., U.S. Cong.

This expansion opened new opportunities for U.S. banks, but also shifted the focus away from domestic activities like municipal financing.[116] At the same time, U.S. banks were exposing themselves to new risks, highlighted by the failure of the German bank Herstatt. Counterparties that had paid German Deutschmarks to Herstatt failed to receive their corresponding dollar payments in return, demonstrating the dangers of foreign exchange settlement.[117]

As shown by Table 2, U.S. banks' operations abroad were concentrated in major trading partners and international financial hubs, namely the U.K., Canada, Australia, Hong Kong, Brazil, and offshore jurisdictions. In addition to financing manufacturing, EACs were used as vehicles to invest in mining and other extractive industries, both abroad and in the U.S.[118]

Table 2: Global Reach of U.S. Banks
Foreign subsidiaries of U.S. banks, BHCs & EACs, 1975

Location	Number	Percent	Total Assets ($bn)	Percent
Europe	324	50.2	15.1	60.6
Canada	93	14.4	3.0	11.9
Latin America	61	9.5	1.0	4.0
Australia	60	9.3	1.7	6.8
Offshore jurisdictions	45	7.0	2.5	10.0

116 *See* KIM PHILLIPS-FEIN, FEAR CITY: NEW YORK'S FISCAL CRISIS AND THE RISE OF AUSTERITY POLITICS, 75–76 (Metropolitan Books 2017).

117 *See* Charles M. Kahn & William Roberds, *The CLS Bank: A Solution to the Risks of International Payments Settlement?*, 4–5 (Fed. Rsrv. Bank of Atl. Working Paper No. 2000-15a, Nov. 2000).

118 *See* McGuire, *supra* note 37, at 440 (describing EAC investments in iron ore mining in Africa and Australia); *see also* JOINT ECON. COMM., *supra* note 37, at 167 (noting banks' use of EACs to finance domestic offshore drilling projects).

Asia/Pacific	44	6.8	1.1	4.6
Israel	18	2.8	0.6	2.6
Total	**645**	**100**	**24.9**	**100**

Source: Norman S. Fieleke, The Growth of U.S. Banking Abroad: An Analytical Survey (Prepared for "Key Issues in International Banking," Fed. Reserve Bank of Bos., Oct. 1977)

U.S. policymakers continued expanding EACs' privileges in service of promoting international competition. In 1975, the Fed revised Regulation K's application to state member banks. Under the Fed's interpretation, the FRA prohibited state member banks from establishing operating subsidiaries abroad, unless they availed themselves of the FRA's provisions expressly permitting foreign investments, which included the Edge Act.[119] EACs thus remained one of the limited avenues by which U.S. banks could operate abroad. In 1977, the Fed permitted U.S. banks' EAC subsidiaries to raise debt in foreign markets and transfer the proceeds to their parent BHCs for domestic use.[120]

1. The International Banking Act and Super Edges

Assets held by EACs and ACs nearly doubled from 1972 to 1976, growing from about $6 billion to $11.6 billion, and by 1977 there were 116 registered EACs.[121] Congress was encouraged that EACs had "no doubt assisted in the financing of U.S. exports," but echoed the familiar refrain that an "antiquated statutory and regulatory framework" has "hampered their "usefulness" and "has put them at competitive disadvantages."[122] The International Banking Act of 1978 (IBA) was meant to "mitigate any competitive disadvantage resulting from the line of business restrictions found within U.S. law" by allowing U.S. banks to engage in activities overseas that were impermissible at home, at the same time subjecting Foreign Banking Operations (FBOs) to greater oversight of their U.S. operations.[123]

The IBA targeted three types of banking law provisions: (1) those that "discriminate" against FBOs, (2) those that "disadvantage or unnecessarily restrict or limit" EACs in their competition with FBOs at home and abroad, and (3) those that impede the Edge Act's longstanding policy that U.S. banks should

119 *See* 40 Fed. Reg. 12252 (Mar. 18, 1975), codified at 12 C.F.R. § 250.143.
120 *See* 63 FED. RES. BULL. 59 (Jan., 1977).
121 *See* Pinsky, *supra* note 75, at 25, 28, 31.
122 S. REP. No. 95-1073, at 4 (1978).
123 *See id.*; *see also* Baxter and Freis, *supra* note 34, at 62.

facilitate exports and trade.[124] The IBA incorporated a new policy statement into the Edge Act that established the following goals:

> [T]o provide for the establishment of international banking and financial corporations operating under Federal supervision with powers sufficiently broad to enable them to compete effectively with similar foreign-owned institutions in the United States and abroad; to afford to the United States exporter and importer in particular, and to United States commerce, industry, and agriculture in general, at all times a means of financing international trade, especially United States exports; to foster the participation by regional and smaller banks throughout the United States in the provision of international banking and financing services to all segments of United States agriculture, commerce, and industry, and, in particular small business and farming concerns; to stimulate competition in the provision of international banking and financing services throughout the United States; and, in conjunction with each of the preceding purposes, to facilitate and stimulate the export of United States goods, wares, merchandise, commodities, and services to achieve a sound United States international trade position.[125]

These policies were meant to guide any future revisions that the Fed made to Regulation K, which the IBA required it to review every five years.[126] The IBA's drafters wanted to clarify that the Edge Act's "emphasis is on financing exports; and that is where it should be in order to establish and maintain a sound U.S. trade position."[127]

The IBA eliminated the limitations on EAC's assumption of debt in excess of ten times its capital as well as the requirement that each EAC maintain reserves equal to 10% of its U.S. deposits.[128] It also removed the prohibition against foreign citizens serving as officers and directors of EACs, and permitted FBOs to become majority owners of EACs.[129] The law sought to create parity

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124 Pub. L. No. 95-369, § 3(a), 92 Stat. 607, 608 (Sept. 17, 1978) (codified at 12 U.S.C. § 611).

125 Pub. L. No. 95-369, at § 3(b).

126 *See* S. REP. NO. 95-1073, at 20.

127 S. REP. NO. 95-1073, at 5.

128 *See* Pub. L. No. 95-369, at § 3(d), (e).

129 *See id.* at § 3(c), (f).

between FBOs and U.S. banks with respect to establishing branches and engaging in interstate banking.[130]

While the four points in the IBA policy statement were generally consistent with the Edge Act's original purposes, policymakers largely focused on the first policy—competitiveness—after the IBA's passage. By the 1980s, most large banks, including all fourteen banks with more than $10 billion in assets, owned EACs, and forty-eight banks with $3 billion or more in assets accounted for 95 of the 131 EACs in existence.[131] Banks used EACs to finance trade abroad through a variety of unique products and markets, including foreign exchange, letters of credit, bankers acceptances, and Eurocurrency.[132] They used their EACs to invest in foreign financial companies, including nonbanks and banking organizations, as well as in passive equity-type "merchant banking" investments in nonfinancial businesses abroad.[133] The competitiveness of U.S. banks was becoming an end in itself, rather than a means to promoting U.S. trade, exports, and manufacturing.

Again, EACs were used to arbitrage domestic banking restrictions. After the IBA's enactment, the Fed amended Regulation K to allow EACs of U.S. banks to branch domestically, subject to Fed approval.[134] Banks could establish as many EAC branches as the Fed permitted, and by consolidating disparate EACs into one EAC with multiple branches, the 10 percent individual lending limit of the consolidated EAC's capital was available to each branch location.[135]

Establishing an EAC allowed banks to operate in more regional markets, namely New York, but also San Francisco and Miami, evading interstate branching restrictions, an option generally only available to large banks given the $2 million minimum

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130 *See id.* at §§ 4, 5. The IBA also required the Department of the Treasury to study the treatment of U.S. banks abroad. *See id.* at § 9. Congress was not concerned with treatment in Europe, but primarily with the restrictions that Japan was placing upon foreign banks' operations. *See* S. REP. NO. 95-1073, at 18.

131 *See* Abrams, *supra* note 96, at 9.

132 *See id.*, at 5–8. The Fed's post-IBA revisions to Regulation K expanded the forms of trade financing that EACs could engage in, including forms with more attenuated connections to exports. *See* James L. Floorman, *Revised Regulation K: Selected Issued Affecting Banking Edge Corporations*, 1980 U. ILL. L.F. 41, 53–54 (1980)

133 *See* Valentine V. Craig, *Merchant Banking: Past and Present*, 14 FDIC BANK. REV. 29, 32 (2001).

134 *See* International Banking Operations; Final Rule Revision, 44 Fed. Reg. 36005, 36009 (June 20, 1979).

135 *See* Douglas H. Ginsburg, *Interstate Banking*, 9 HOFSTRA LAW REV. 1133, 1193 (1981).

capital requirement.[136] In the mid-1950s, there were two banks with EACs in New York: Bank of America, New York, and Bank of Boston International. By 1966 there were nine, established by banks in Boston, Minneapolis, Pittsburgh, Chicago, Los Angeles, and San Francisco.[137]

Beginning in the early 1970s, banks focused on Miami as a hub of EAC activity, given Miami's trade relationship with Latin America, particularly the growth of direct exports to Latin America, the number of companies that had established their Latin America operations in Miami, and the desire to attract deposits from Latin American clients.[138] In 1977, there was greater regional dispersal, with 38 of the 116 EACs in existence in New York, twelve in Los Angeles, eleven in Chicago, ten in Miami, and nine in Houston.[139]

In the eighteen months following the 1979 Regulation K revisions, eleven banks received approval to establish in total twenty-eight EAC branch offices.[140] A review of Federal Register publications in the decade following the IBA's passage, as depicted in Table 3, demonstrates the benefits that law provided to the banking industry.[141]

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[136] *See* Dahl, *supra* note 9, at 110; *see also* Ginsburg, *supra* note 135, at 1193; *see also* McGuire, *supra* note 37, at 438.

[137] *See* Dahl, *supra* note 9, at 110; *but see* Pinsky, *supra* note 75, at 31 ("By 1966, there were 36 Edge Act corporations, 18 of them in New York.").

[138] *See* McGuire, *supra* note 37, at 442–43.

[139] *See* Pinsky, *supra* note 74, at 31.

[140] *See* Ginsburg, *supra* note 135, at 1193; *see also* CMTE. ON BANKING, HSG. & URBAN AFF., *Reports to Congress Under the International Banking Act of 1978* 6 (1980) ("In the fifteen months since branches have been permitted, the Board has approved the establishment of 39 new banking Edge Corporation offices, 11 of which are in six cities that did not previously have Edge banking offices. Of these new offices, 27 were branches, including all of the offices in cities that did not previously have Edge Act banking. This compares with only two new Edge banking offices established in 1978 and two in 1977.").

[141] While not all EAC activity is readily available and easily documented, the establishment of any new EAC is required to be published in the Federal Register. *See* 12 C.F.R. § 211.5(b)(3).

Table 3: Building "Super Edges"
Edge Act activity after the IBA, 1978–1990

Year	Applications[142]	Domestic Banks		Foreign Banks	
		EACs	*Branches*	*EACs*	*Branches*
1978-1980	35	16	52	5	0
1981-1990	83	31	59	21	10
TOTAL	118	47	111	26	10

Source: Federal Register

These figures illustrate the growth of domestic Edge Act activity in the wake of the IBA, as assets held in EACs tripled from 1978 to 1981.[143] U.S. BHCs used EACs to expand their U.S. operations, broadening their branch networks in circumvention of the prohibition against interstate branching.[144] The resulting entities, with a parent EAC and a network of branches operating in critical U.S. markets, were known as "super-Edges."[145]

In 1981, the Fed provided additional flexibility for EACs' domestic operations by allowing EACs to invest in foreign companies that operate within the U.S., so long as that company is "predominately engaged" in business outside the U.S., engages in activities "closely related" to banking, and the EAC acquires no more than 25% of the company's equity.[146]

The Competitive Equality Banking Act of 1987 (CEBA) responded to the growth of nonbank-banks, entities that engaged in bank-like activities without the regulatory and supervisory regimes applicable to banks, including enabling their parent companies, often commercial businesses, to avoid BHC registration requirements.[147] EACs were among the nonbank-banks that were excluded from CEBA's expanded definition of "bank," which was

142 A single application can contain multiple legal actions, including establishing an EAC, establishing a branch, relocating a home office, renaming an EAC, and other reorganizations.

143 *See* Janis Johnson, *Edge Act Builds Banking Bridge From Florida Abroad*, WASH. POST (May 3, 1981), https://perma.cc/R9JT-BL33.

144 For further discussion of branching and consolidation of EACs post-IBA, see Floorman, *supra* note 132, at 42–48.

145 *See* Irwin Jay Robinson, *The Use of Edge Act Corporations Formed under the Laws of the United States of America by Foreign Banks*, 17 INT. LAWYER 407, 414 (1983).

146 International Banking Operations; Investments by United States Banking Organizations in Foreign Companies, 46 Fed. Reg. 8437 (Jan. 27, 1981).

147 *See* S. REP. 100-19, 5–10 (1987).

meant to capture previously un-addressed deposit activities and lending.[148] At the same time, CEBA extended the restrictions on bank lending to insiders and prohibitions against tying to EACs.[149] Thus, while CEBA's intent was strengthening the separation of banking and commerce, much of EACs' special, nonbank-bank status remained even after the law's passage.

As U.S. BHCs expanded their branch networks, the number of EACs and ACs declined, from one hundred and twenty-six in 1980 to one hundred in 1990.[150] In 1994, Congress enacted the Riegle-Neal Interstate Banking Efficiency Act, permitting national banks to engage in interstate branching.[151] Industry stakeholders and policymakers argued that U.S. banks' inability to branch across states was preventing them from competing internationally; conversely, interstate branching would help preserve their market share in exporting industries.[152] Authorizing

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148 *See* Pub. L. No. 100-86, § 101(a), 101 Stat. 565 (1987); *see also* S. REP. No. 100-19, at 11. More precisely, all existing EACs enjoyed grandfathered exclusion from the definition of "banks," while EACs established after CEBA's enactment would be subject to certain provisions of section 4 of the BHCA. *See* S. REP. No. 100-19, at 30, 37. The law contained one specific exception to the section 4 requirement, for a pending application by the U.K.'s Midland Bank, Plc., proposed by the House of Representatives. *See* Pub. L. No. 100-86, at § 102(c)(2); *see also* H. REP. NO. 100-261, 134 (1987).

149 *See* S. REP. NO. 100-19, at 13. The Fed's Regulation O governs banks' extensions of credit to their executive officers, directors, or principal shareholders of that bank, the bank holding company of which the member bank is a subsidiary, and of any other subsidiary of that bank holding company. *See* 12 C.F.R. § 215.1(b)(1). Banks must offer credit to insiders on the same terms as it would be offered in an arms-length transaction. *See* 12 C.F.R. § 215.4(a).

The BHCA prohibits banks from tying, meaning conditioning the extension of credit, leases or sales of property, or the furnishing of any service on a customer's willingness to engage in other transactions with the bank. *See* 12 U.S.C. § 1972(1). Illegal tying involves two or more financial products—the customer's desired product(s) and the separate, tied product(s)—with a bank requiring a customer to obtain a tied product, from the bank or its affiliate, as a condition of acquiring the desired product. *See* 68 Fed. Reg. 52024, 52027-29 (Aug. 29, 2003) (discussing the elements of illegal tying). Certain "traditional bank products," including loans, deposits, or trust services, are exempt from anti-tying restrictions. *See* 12 U.S.C. § 1972(1).

150 *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., 67TH ANNUAL REPORT (1980); BD. OF GOVERNORS OF THE FED. RSRV. SYS., 77TH ANNUAL REPORT (1990).

151 *See* Pub. L. No. 103- 328, §§ 101–03, 108 Stat. 2339 (1994). Eventually, the Dodd-Frank Act would remove any remaining limits against de novo interstate branching for banks, even under state law. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 613, 124 Stat. 1376, 1614 (2010).

152 *See* Patrick Mulloy & Cynthia Lasker, *The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994: Responding to Global Competition*, 21 HARV. J. ON LEGIS. 255, 261–62 (1995); *see also id.*, at 268–69 (quoting then-Secretary of Commerce Ron Brown leter to Senate Banking Committee Chairman Donald Riegle stating that "The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 will . . . strengthen our banking system's ability to help U.S. exporters.").

interstate banking diminished EACs' utility in circumventing branching restrictions.[153]

2. Public-Private Partnership: Edge Corporations and Export Credit Agencies

While EACs' role as conduits for U.S. trade financing has been framed as an exclusively private endeavor, they have frequently benefitted from various kinds of government support. The 1960s saw the beginning of bank partnerships with foreign governments, with EACs making investments in government-sponsored development banks in India, Pakistan, and Nigeria.[154] EACs also invested in sovereign development entities and their projects through loans, bond purchases, and other forms of financing, in addition to multilateral development bodies like World Bank subsidiary International Finance Corporation (IFC) or the U.S. Agency for International Development (USAID).[155] EACs have been eligible for insurance through USAID for investments in less-developed economies, protecting them from risks such as inconvertibility, expropriation, and disturbances caused by wars or civil unrest.[156]

EACs also partnered with U.S. export credit agencies to fund international projects.[157] In 1982, Congress passed the Bank Export Services Act (BESA), which aimed to "increase United States exports of products and services by encouraging more efficient provision of export trade services to United States producers and suppliers," including by permitting BHCs or their subsidiary EACs to invest in export trading companies (ETCs).[158] An ETC is a U.S. company that is "exclusively engaged in activities related

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153 *See* FEDERAL RESERVE BOARD ORAL HISTORY PROJECT: INTERVIEW WITH MICHAEL G. MARTINSON 2 (Mar. 3, 2010), https://perma.cc/ZR5C-PD7G [hereinafter INTERVIEW WITH MICHAEL G. MARTINSON].

154 *See* Dahl, *supra* note 9, at 112.

155 *See* Bossy, *supra* note 109, at 92 (describing a 1964 financing arrangement for the Philippines involving equity purchases by the IFC and EACs, as well as loans from the World Bank and AID).

156 *See id.*

157 Such examples include a $17 million loan made by Continental Illinois' EAC, together with the EXIM Bank, to an oil firm building a catalytic cracking plant in Romania. *See* McGuire, *supra* note 37, at 440.

158 *See* Pub. L. No. 97-290, §§ 102(b), 203, 96 Stat. 1233, 1236 (1982) (codified at 12 U.S.C. § 1843(c)(14)). These activities are subject to Fed review and a set of limitations. For example, EACs that are subsidiaries of BHCs are permitted to invest in ETCs, but EACs that are subsidiaries of banks are not. *See* 12 U.S.C. § 1843(c)(14)(E). A banking EAC may invest up to 5% of its capital in an ETC, while an investment EAC may invest up to 25% of its capital in an ETC. *See* 12 C.F.R. § 211.33(a).

to international trade, and which is organized and operated principally" for the purpose of exporting U.S. goods or providing export trade services to facilitate the exporting of U.S. goods.[159] Allowing BHCs to own ETCs deepened the public-private partnership at the heart of the Edge Act.[160] BESA directed the EXIM Bank to establish programs to guarantee ETC-financed loans when private financing was not otherwise available,[161] serving as a guarantor of last resort for banks' export financing activities.

Again, deregulation was meant to solve such vexing problems as the trade deficit, the value of the dollar relative to foreign currencies, and the risks of inflation.[162] Industry promised that the legislation would produce new manufacturing jobs, while some members of Congress expressed doubts about further undermining the separation of banking and commerce.[163] Ensuring the "meaningful and effective participation" of private financial companies in "the financing and development of export trading companies," was supposed to make export financing more competitive, realize economies of scope, and coax regional banks and small- and medium-sized enterprises into international trade.[164]

Deregulation again came up short as a tool of trade and export policy. Following the passage of BESA, there was "relatively slow development of bank-affiliated export trading companies," with only forty-five BHCs applying to establish ETCs.[165] Acknowledging that this lackluster activity "may have been significantly influenced by the adverse economic climate that made exporting difficult for all sectors of the U.S. economy, as well as the unfamiliarity of U.S. bank holding companies and manufacturers with ETCs as vehicles for export trade," Congress nonetheless pinned some of the blame on "unduly restrictive" Fed regulations.[166] The

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159 12 U.S.C. § 1843(c)(14)(F).

160 *See* Joseph J. Norton, *The Efficacy of Export Trading Companies and Related Legislation and Regulations*, 50 J. AIR L. & COM. 865, 868 (1985) (BESA enacted a "new framework for improving the United States export industry through the cooperative efforts of the government (federal and state), the domestic banking community, and those U.S. based companies engaged in or interested in competing in international markets.").

161 *See* Pub. L. No. 97-290, at § 206 (codified at 12 U.S.C. § 635a–4).

162 *See id.*, at § 102(a).

163 *See* Norton, *supra* note 160, at 867–69.

164 *See* Pub. L. No. 97-290, at § 202.

165 S. REP. NO. 100-85, at 21 (1987); *see also* BD. OF GOVERNORS OF THE FED. RSRV. SYS., 75TH ANNUAL REPORT 179 (1988).

166 S. REP. NO. 100-85, at 21–22. The macroeconomic factors cited by Congress included the "rise of the dollar against foreign currencies, the relatively sluggish growth of foreign economies, and the drop in imports by countries experiencing problems meeting their external debt obligations." *Id.* at 22.

Export Trading Company Act Amendments of 1988 further deregulated BHC-owned ETCs, including by increasing the amount of leverage they could employ.[167] These tweaks had seemingly little effect, as the total number of ETCs increased by just three, to forty-eight by 1996.[168]

These new legal entities and public programs were an important milestone in international banking. While originally driven by the dual aims of financial competitiveness and export promotion, the banking laws were now largely focused on the competitiveness of U.S. banks. Exports, trade promotion, and the financing thereof, was becoming the public sector's responsibility.[169] Thus, EACs not only benefitted from deregulation in the name of facilitating trade and industry, but they also shifted some of the risks of operating internationally onto the U.S. government.[170]

3. Risky Markets: Sovereign Debt and Money Laundering

Banks predominately used their super-Edges to target domestic markets with a nexus to international trade. Banks' branch applications were often reorganizations, establishing an EAC in a bank's home city with branches in regional trade hubs.[171] As mentioned above, Miami was a focal point for EAC activity in

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167 *See id.* at 23–25. Banks' extension of credit or advances to ETC affiliates for financing the purchase of goods are also exempt from section 23A, where 1) the ETC has a contract to resell any goods purchased; and 2) the bank has a security interest either in the goods or the proceeds from the sale. *See* 12 C.F.R. § 211.33(b)(2). An EAC invested in an ETC may not extend credit to the ETC in excess of 10% of its capital. *See* 12 C.F.R. § 211.33(b)(1).

168 *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., 83RD ANNUAL REPORT 233 (1996).

169 *See* 12 U.S.C. § 635(a)(1) ("[The [Export-Import] Bank's objective in authorizing loans, guarantees, insurance, and credits shall be to contribute to maintaining or increasing employment of United States workers."). The flexibility enjoyed by EACs was often justified on the basis of their expertise and familiarity with foreign markets and governments, and the unique risks of international trade. Yet these risks, including foreign exchange, geopolitics, and international transport, were proffered as justifications for why private markets will not engage in certain export financing, thereby necessitating a government backstop for the financing that private banks provide to U.S. manufacturers. *See* GOV'T ACCOUNTABILITY OFF., EXPORT-IMPORT BANK: RECENT GROWTH UNDERSCORES NEED FOR CONTINUED IMPROVEMENTS IN RISK MANAGEMENT 5 (Mar. 2013), https://perma.cc/4ZQY-QX2F.

170 In the context of international development financing, nation states have played an increasing role in "de-risking" private sector financial assets. *See* Daniela Gabor, *The Wall Street Consensus*, 52 DEV. & CHANGE 429 (2021). Such "[f]inancial de-risking captures a range of public subsidies and guarantees," including the types of guarantees offered by export credit agencies such as the EXIM Bank. *Id.* at 434. These programs contemplate a larger role for public authorities, but only in the limited capacity of subsidizing the private sector.

171 *See* Robinson, *supra* note 145, at 414, n. 50.

the late 1970s and early 1980s due to its proximity to Latin America and state laws encouraging international banking.[172]

During this period, large U.S. banks' exposure to loans in developing countries, particularly in North and South America, increased substantially,[173] leading to concerns about the stability of the U.S. banking system. In 1977, Fed Chair Arthur Burns "warned repeatedly that bank lending to less developed nations was proceeding at a pace 'too fast' to be sustained."[174] After two oil price shocks during 1973–74 and 1979–80, Mexico and Argentina defaulted on some bond payments in 1982, escalating the level of the banking system's exposures "from the category of 'problem' to 'crisis.'"[175]

The policy response mixed regulation and relaxation. In 1987 and 1988, the Fed allowed EACs to invest through debt-for-equity conversions. U.S. banks could restructure troubled foreign loans through debt-for-equity swaps and joint ventures with sovereign entities, allowing foreign governments to convert dollar loan repayments into local currency that would be reinvested in companies or sovereign entities in the same jurisdiction.[176] EACs were allowed to invest up to 100% and 40% in the equity of sovereign and privately owned nonfinancial foreign ventures,

172 *See* Johnson, *supra* note 143. One perspective at this time held that the proliferation of EACs and tax-free banking could help to establish Miami as an offshore banking center located within the U.S. *See id.* There is some evidence that the Fed granted U.S. banks' EAC applications in the Cayman Islands in order to facilitate their customers' tax avoidance from the 1970s through the 1990s and 2000s. *See* INTERVIEW WITH MICHAEL G. MARTINSON, *supra* note 153, at 11-12

173 From 1973–1983, large U.S. banks' lending to non-OPEC developing countries increased by 700% and accounted for about 1/3 of the debt in such countries. *See* H. REP. No. 98-175, 31 (1983). By 1982, the nine largest U.S. banks had lent over $30 billion to Argentina, Brazil, and Mexico, an amount equal to almost 140% of their capital. *See id.*, at 35. In addition to large banks, Allied Bank, an EAC created by a consortium of regional banks, suffered substantial losses on loans to companies in Latin America. *See* Robert A. Bennett, *Allied Bank: Victim of its Latin Lending*, N.Y. TIMES (Aug. 21, 1983), https://perma.cc/MGU8-L9C4.

174 H. REP. NO. 98-175, at 33. In a familiar dynamic, banks ignored these warnings, engaged in herd-like behavior, and insisted to regulators that their expertise and capitalization should alleviate any potential concerns. *See id.*, at 33–34.

175 *Id.*, at 35.

176 *See* Craig, *supra* note 133, at 33 ("As a result of the LDC (less-developed-country) debt crisis, many banks received private equity from developing nations in return for their defaulted loans."); *see also* Gruson, *supra* note 64, at 442, 468. Banks and BHCs may also own shares in nonfinancial companies "in satisfaction of a debt previously contracted in good faith[.]" *See* 12 U.S.C. § 1843(c)(2); *see also* 12 C.F.R. § 1.7.

respectively,[177] subject to holding and divestiture periods and exposure limits.[178]

Congress also determined that, along with broader macroeconomic trends, lax bank supervision contributed to the indebtedness of certain countries and the related default risk exposure of some banks.[179] The International Lending Supervision Act of 1983 (ILSA) directed regulators to strengthen banks' capital adequacy by increasing capital requirements, particularly for international lending.[180] ILSA required supervisors to evaluate foreign country exposures and transfer risks, and banks to report regularly on these risks.[181] ILSA required regulators to establish reserve requirements for foreign country risk, and set special requirements for highly indebted countries.[182] Finally, ILSA required additional documentation and examination of banks' risks from large foreign loans related to mining, metal and mineral processing, or fabrication.[183] At the same time, ILSA directed the Treasury Secretary and the banking regulatory agencies to encourage their foreign counterparts to "work toward maintaining and, where appropriate, strengthening the capital bases of banking institutions involved in international lending,"[184] a provision that would help to spur the Basel I International Capital Accord.[185]

Increased exposure to money laundering schemes was a second consequence of international expansion during the 1970s and 80s. The Bank of Credit and Commerce International (BCCI) was a notable example of this vulnerability. BCCI was a Luxembourg-based foreign holding company founded in 1972, with banks chartered in London and the Cayman Islands and head offices in Karachi and London, the largest shareholder of which was the

177 *See* 12 C.F.R. § 211.8(g)(1). This provision "marked the first time that U.S. banks were permitted to own 100% of the shares of a commercial or industrial company." Gruson, *supra* note 64, at 469. Initially, only EAC subsidiaries of BHCs, but not banks, were permitted to invest in debt-for-equity conversions, *see id.*, at 474 n.177, however, indirect investments by bank subsidiaries were permitted with the Fed's approval, *see* 12 C.F.R. § 211.8(g)(2).

178 *See* 12 C.F.R. § 211.8(g)(1)(ii)(B), (3). BHCs have general consent from the Fed to invest under $25 million or 1% of their Tier 1 capital; specific consent is required for transactions above those thresholds. *See* 12 C.F.R. § 211.8(g)(4).

179 *See* H. REP. No. 98-175, at 30–31.

180 Pub. L. No. 98-181, § 908, 97 Stat. 1278, 1280 (1983) (codified at 12 U.S.C. § 3907).

181 *See id.* at §§ 904, 907.

182 *See id.* at §§ 905, 905A.

183 *See* 12 U.S.C. § 3908.

184 *See* Pub. L. No. 98-181, at § 908(b)(3)(C) (codified at 12 U.S.C. § 3907(b)(3)(C)).

185 *See* TARULLO, *supra* note 9, at 45–85.

sovereign wealth fund of Abu Dhabi.[186] Beginning in 1987, U.S. regulators detected irregularities in BCCI's U.S. operations, first with respect to suspicious money laundering activities occurring in BCCI's Miami agency that resulted in criminal indictments and the Fed issuing a cease-and-desist order.[187] From 1991 through 1992, BCCI's international holding company and one of its U.S. subsidiaries were liquidated.[188]

In response to the supervisory failures uncovered by this episode, regulators established an international supervisory college for examining and supervising international banking institutions in 1988.[189] In its immediate aftermath, Congress enacted the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA), which augmented the Fed's role in consolidated supervision of international banking conglomerates, as well as in oversight of FBOs' U.S. operations.[190]

Riggs Bank was another example of money-laundering risk. Riggs filed its application to create a Miami-based EAC with the Fed in 1980, which then opened in 1981.[191] The risks of money laundering activities in the Miami market were well known at the time.[192] During 1994–2002 and 1995–2004, Riggs facilitated illicit banking services for Argentinian dictator Augusto Pinochet and members of the regime in Equatorial Guinea, respectively. Riggs' Edge Act subsidiary Riggs International Banking Corporation

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186 *See* INTERVIEW WITH MICHAEL G. MARTINSON, *supra* note 153, at 44 n.4; *see also* U.S. GEN. ACCT. OFF., INITIAL ASSESSMENT OF CERTAIN BCCI ACTIVITIES IN THE U.S. 2, 4 (1992).

187 *See* GEN. ACCOUNTING OFF., *supra* note 187, at 27. After examining BCCI's U.S. operations, the Fed also determined that BCCI had taken a controlling position in a U.S. bank, which owned an EAC subsidiary in Miami, without Fed approval, in violation of the BHCA. *See id.* at 22; *see also id.* at 53. In addition, BCCI and the U.S. banks that it had surreptitiously controlled were found to have engaged in a series of potentially inappropriate or illegal transactions, including extensions of credit. *See id.* at 28.

188 *See id.* at 5–7.

189 *See id.* at 3.

190 *See* Joseph J. Norton & Christopher D. Olive, *A By-Product of the Globalization Process: The Rise of Cross-Border Bank Mergers and Acquisitions—The U.S. Regulatory Framework*, 56 BUS. LAW. 591, 598–603 (2001).

191 *See* Riggs Int'l Banking Corp., Corporation to do Business Under Section 25(a) of the Federal Reserve Act, 45 Fed. Reg. 27826, 27826 (Apr. 24, 1980); *see also* Johnson, *supra* note 143.

192 *See* Johnson, *supra* note 143 ("'And let's put aside the drug money,' [one banker] said. 'Because listen, nobody's down here for that. It's blight on this community, and it really is hindering things and has to be resolved because it is putting legitimate business growth in danger.' Miami bankers are particularly sensitive about that subject. About 10 banks are part of a federal grand jury investigation into bank laundering of drug dealers' money.")

(RIBC) was a participant in this activity.[193] Riggs agreed to a consent order with the Fed to address RIBC's deficient Bank Secrecy Act and Anti-Money Laundering (AML) compliance.[194] Riggs closed RIBC on December 31, 2004[195] and pled guilty to a felony count of failing to file suspicious-activity reports (SARs) accompanied by a $16 million penalty.[196] Compliance issues across the broader Riggs enterprise metastasized to such a level that Riggs eventually needed to be rescued by the bank PNC.[197] A Senate investigation into money laundering practices at U.S. banks, including Riggs, resulted in provisions of the USA Patriot Act of 2001 that required updates to the AML provisions of Regulation K.[198]

While Riggs and BCCI are among the highest-profile examples of the money laundering risks from Edge banking, they are not the only ones. Shortly after the Riggs case, BSA/AML violations by American Express's EAC, American Express Bank International of Miami, Florida (AEBI) resulted in a Deferred Prosecution Agreement with the Department of Justice (DOJ) that included forfeiture of $55 million, a $25 million fine by the Treasury Department's Financial Crimes Enforcement Network (FinCEN), and a cease-and-desist order and $20 million penalty from the Fed.[199] AEBI was used by Colombian drug cartels to facilitate the "Black Market Peso Exchange" scheme to launder $55 million

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193 *See* PERMANENT SUBCMTE. ON INVESTIGATIONS, *Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act* 12-37 (2004), https://perma.cc/KS67-NPLU. The Equatorial Guinea services included corrupt payments from U.S. multinational oil companies. *See id.* at 98–108.

194 *See* Consent Order in re Riggs Nat'l Corp., Docket Nos. 04-011-B-HC, 04-011-B-EC (May 14, 2004), https://perma.cc/F9GD-KGEQ. Riggs was also subject to several other enforcement actions by financial regulators. *See* Securities & Exchange Comm'n, The PNC Financial Services Group, Inc., et al.; Notice of Application, 70 Fed. Reg. 21829, 21830 n.1 (Apr. 27, 2005).

195 *See* Consent Order in re Riggs Nat'l Corp., Docket No. 05-003-B-HC (Jan. 26, 2005), https://perma.cc/LV3R-7REL.

196 *See* 70 Fed. Reg. at 21830.

197 *See* Formations of, Acquisitions by, and Mergers of Bank Holding Companies, 69 Fed. Reg. 50382 (Aug. 16, 2004).

198 *See* PERMANENT SUBCMTE. ON INVESTIGATIONS, *supra* note 193, at 1. EACs are required to file suspicious-activity reports and have systems "reasonably designed to assure and monitor compliance" with the Bank Secrecy Act, as well as a customer identification program. *See* 12 C.F.R. § 211.5(k), (m).

199 *See* U.S. v. Am. Express Bank, Int'l, Docket No. 07-20602-CR-ZLOCH (S.D. Fla. 2007); *see also* Assessment of Civil Money Penalty in re Am. Express Bank, Int'l, No. 2007-1 (Aug. 3, 2007); *see also* Cease and Desist Order and Order of Assessment in re Am. Express Bank, Int'l, Docket No. 07-017-B-EC at 2 (Aug. 3, 2007).

in drug proceeds from 1999–2004.[200] AEBI was also the subject of a Fed enforcement action and a DOJ settlement in 1993 and 1994, respectively, for BSA/AML violations related to the Mexican Gulf drug cartel.[201]

III. WHERE WE ARE: THE ERA OF MODERNIZATION

The prevailing economic policy framework of the late 1980s and 1990s "subjugate[ed] both the governing agenda of American democracy and the direction of global economic development to the currents of international capital markets."[202] This period was marked by globalization in the form of liberalized international trade policy. The world's major economies established the World Trade Organization (WTO) to manage trade relationships with an eye toward reducing barriers; trade relations between China and other major trading nations were normalized; and the U.S entered the North American Free Trade Agreement (NAFTA).[203] Globalization was accompanied by financial "modernization" in the form of deregulation. In 1986, the U.K. enacted its "Big Bang" policy agenda of financial deregulation, temporarily giving London an advantage as the major global banking center.[204]

By 1996, seventy-three EACs and ACs, with total parent-only assets of $40 billion, were operating forty-two domestic branches.[205] Overseas subsidiaries of U.S. banks grew in assets from $7 billion in 1970 to $81 billion by 1980, to $191 billion by 1990, and $718 billion by the end of 1998.[206] As Table 4 shows, London was the most popular jurisdiction by the number of subsidiaries (110), just ahead of the Cayman Islands (106), as well as

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200 *See* Deferred Prosecution Agreement, *U.S. v. Am. Express Bank, Int'l*, Docket No. 07-20602-CR-ZLOCH at 3 (S.D. Fla. 2007), https://perma.cc/P87N-C66X.

201 *See id.*, at 10–11; *see also* Cease and Desist Order and Order of Assessment in re Am. Express Bank, Int'l, Docket No. 07-017-B-EC at 2 (Aug. 3, 2007).

202 CARTER, *supra* note 26, at 492.

203 *See id.* at 493–504.

204 *See* WILMARTH, *supra* note 26, at 194–95.

205 *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., 83RD ANNUAL REPORT 233 (1996), https://perma.cc/G49N-QHSS. That year, the Economic Growth and Paperwork Reduction Act of 1996 (EGRPRA) lifted the limit that member banks could invest in EACs, subject to Fed approval, from 10 percent of the stock and surplus of the subsidiary to 20 percent of the stock and surplus of the subsidiary. *See* Pub. L. No. 104-208, tit. II, § 2307, 110 Stat. 3009, 3009-426 (1996).

206 *See* James V. Houpt, *International Activities of U.S. Banks and in U.S. Banking Markets*, 85 FED. RESERVE BULL. 599, 605 (1999). As the author notes, "assets provide an incomplete picture of foreign subsidiaries, however, because of the recent growth of trading activities—particularly in London—and the role subsidiaries play in their parents' networks." *Id.*

measured by total assets ($358.3 billion). Seventy percent of these assets—more than $500 billion—were being held in EACs.[207]

Table 4: Pre-Gramm-Leach-Bliley Landscape
Foreign subsidiaries of U.S. banks, 1998

Location	**Number**	**Percent**	**Total Assets ($bn)**	**Percent**
Europe	327	28.9	477.6	66.5
Offshore jurisdictions	211	18.6	66.6	9.3
Latin America	238	21.0	40.5	5.6
Asia/Pacific	151	13.3	46.6	6.5
Middle East	8	0.7	13.4	1.9
Africa	12	1.1	1.0	0.1
Australia	31	2.7	25.9	3.6
Canada	36	3.2	20.9	2.9
U.S. territories & others	60	5.3	9.8	1.4
U.S.	59	5.2	15.6	2.2
Total	**1,133**	**100**	**717.9**	**100**

Source: James V. Houpt, *International Activities of U.S. Banks and in U.S. Banking Markets*, 85 Fed. Res. Bull. 599 (1999).

While these international subsidiaries initially focused on traditional banking and lending, by the late 1990s they had shifted toward trading and securities.[208] More than 60% of the $285 billion in U.S. commercial bank trading assets were booked abroad—in London and, to a lesser extent, Tokyo and Singapore.[209]

During this period, crises in the foreign exchange markets, driven by the volatility of the peso and ruble, caused the collapse of the hedge fund Long Term Capital Management (LTCM).[210] LTCM was saved by public-private rescues, which was a necessity

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[207] *See id.* at 606.
[208] *See id.*
[209] *See id.* at 609.
[210] *See* Lawrence A. Cunningham & David Zaring, *The Three or Four Approaches to Financial Regulation: A Cautionary Analysis Against Exuberance in Crisis Response*, 78 GEO. WASH. L. REV. 39, 53-54 (2009).

given its interconnectedness with Wall Street banks.[211] The LTCM episode reinforced that the risks of international banking exposed during the Herstatt failure and the sovereign debt crisis of the 1970s remained present, this time mixed with the complexity of modern financial instruments known as derivatives.

Despite LTCM's cautionary tale, U.S. banking policy in this period swung toward deregulation. Policymakers expanded the activities in which U.S. banks could engage, culminating in the repeal of the Glass-Steagall limits between banking and securities. As a result, EACs now engage in a range of banking and nonbanking activities, including nonfinancial activities that arguably violate the separation of banking and commerce. These expansions present new and significant challenges for regulating and supervising such sprawling financial enterprises.

A. International Banking and Financial Services Modernization

By the late 1990s, U.S. banks had shifted their international activities from facilitating trade and exports to trading securities and derivatives.[212] The Financial Services Modernization Act of 1999, known as the Gramm-Leach-Bliley Act (GLBA), completed this transformation by permitting BHCs to conduct a broad range of financial activities, including securities underwriting and dealing, and insurance.[213] BHCs were also allowed to engage in commercial activities that the Fed determined to be closely related to banking by making passive private equity-type merchant banking investments and directly owning commodities.[214] GLBA generally envisions these activities being conducted through two vehicles, either a nonbanking subsidiary of a BHC or a financial subsidiary of a bank.

Like many of the laws discussed above, GLBA aspired to "make U.S. financial firms more competitive both domestically and internationally."[215] Notwithstanding U.S. banks' ability to

[211] *See* CARTER, *supra* note 26, at 507–08; *see also* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292, 45294 (July 26, 2013) (LTCM had "avoided collapse only after the Federal Reserve Bank of New York intervened and supervised a financial rescue and reorganization by creditors of the fund.").

[212] *See infra* note 210–11 and accompanying text.

[213] *See* Dafna Avraham, Patricia Selvaggi & James Vickery, *A Structural View of U.S. Bank Holding Companies*, 7 ECON. POLICY REV. 65, 67 (2012).

[214] *See* Saule T. Omarova, *The Merchants of Wall Street: Banking, Commerce, and Commodities*, 98 MINN. L. REV. 265 (2013).

[215] H. REP. NO. 106-74, pt. 1, at 97 (1999); *see also* MetLife Inc. v. Fin. Stability Oversight Council, 177 F. Supp. 3d 219, 224 (D.D.C. 2016) ("The purpose of Gramm-Leach-Bliley was to repeal the Glass-Steagall Act's prohibition on banks affiliating with

provide a wide range of services and activities abroad through their EACs, GLBA's advocates argued that American preeminence in global financial markets would "come into question" if the limitations on banks' activities remained in place.[216] After GLBA, BHCs could engage domestically in any activity that they "engage in outside of the United States" that is "usual in connection with the transaction of banking or other financial operations abroad."[217]

1. International Banking: A Growing Oligopoly

Many of EACs' structural advantages were diminished with the repeals of the McFadden Act's interstate branching restrictions and the Glass-Steagall Act's activity limits.[218] Table 5 shows that the number of EACs declined from ninety-four combined U.S. and Foreign Banking Organization (FBO) EACs in 2000 to forty-three EACs at the end of 2019. Since then, the number of new applications has been moribund, declining from fifty-two during the decade following the passage of the IBA, to nine during the 1990s, five during the 2000s, and four during 2011–2020.

securities firms and other financial institutions, and thus to 'enhance competition in the financial services industry.'"). For example, Fed officials noted the "far less restrictive approach" of German universal banks, enabling Deutsche Bank's nearly 25% equity investment in the automotive manufacturer Daimler-Benz AG. Baxter and Freis, *supra* note 34, at 61.

216 H. REP. NO. 106-74, pt. 1, at 97 (1999); *see also* S. REP. NO. 106-44, at 5 (1999) (quoting former Fed Chair Alan Greenspan statement that "[u]nless soon repealed, the archaic statutory barriers to efficiency could undermine the competitiveness of our financial institutions . . . and ultimately, the global dominance of American finance."). Certain interest groups advocated for allowing the broader range of activities to be conducted directly through banks because EACs "have conducted a broader range of activities as principal outside the U.S. without damage to banks." *Testimony of Chairman Alan Greenspan: Hearing on H.R. 10 and the Financial Services Act of 1998 Before the S. Comm. on Bank., Hous., & Urb. Aff.,* 105th Cong. (June 17, 1998), https://perma.cc/U3U6-X2E4. Notwithstanding its parallel and contradictory argument that *BHCs* should be allowed to conduct the full suite of activities both domestically and abroad on competitive grounds, the Fed argued that because *banks* in the U.S. are not permitted to engage in the full suite of activities domestically, the competition argument was not relevant as applied to banks. *See id.* Proponents also argued that becoming "financial supermarkets," would help BHCs withstand financial shocks by diversifying their risks. *See* Justin Baer & Max Colchester, *When Bigger Isn't Better: Banks Retreat From Global Ambitions*, WALL ST. J. (May 30, 2016), https://perma.cc/282Q-WAP3.

217 12 U.S.C. § 1843(k)(4)(G). The Fed has authority to determine that activities conducted abroad are permissible if they "would not be substantially at variance" with the purposes of the BHCA and permitting them would be "in the public interest." 12 U.S.C. § 1843(c)(13).

218 *See* Houpt, *supra* note 206, at 606.

Table 5: Post-Gramm-Leach-Bliley Realignment
Edge Act activity by decade, 1980-2020

Years	Applications			EACs		
	Total	U.S. EACs	FBO EACs	Total	U.S. EACs	FBO EACs
1981-1990	52	31	21	118	100	18
1991-2000	9	7	2	94	76	18
2001-2010	5	4	1	59	51	8
2011-2020	4	4	0	43	35	8

Source: Federal Register, Federal Reserve

This trend could suggest that the Edge Act has waned in popularity after GLBA authorized BHCs to engage in a wide range of financial, and even some nonfinancial, activities in the U.S. and abroad. More likely, the decline in the number of EACs reflects consolidation that occurred post-GLBA, particularly among the largest U.S. BHCs in which EAC ownership is concentrated.[219] Due in part to the mergers that followed deregulation, the banking industry is more concentrated now than it was in 1990.[220] Consistent with the broader trend toward concentration, the banking

[219] *See* Donald I. Baker, *From Philadelphia National Bank to Too Big to Fail: How Modern Financial Markets Have Outrun Antitrust Law as a Source of Useful Structural Remedies*, 80 ANTITRUST L.J. 353, 357–62 (2015).

[220] *See* Robert Adams & John Driscoll, *How the Largest Bank Holding Companies Grew: Organic Growth or Acquisitions?*, FEDS NOTES (2018), https://perma.cc/7EC6-GADQ. The share of assets held by the 5 largest U.S. commercial banks has grown from 28% in 2000 to 46% in 2017. *See* FRED, FED. RSRV. BANK OF ST. LOUIS, 5-BANK ASSET CONCENTRATION FOR THE UNITED STATES https://perma.cc/4K5W-9HYW. The 8 U.S. Globally Systemically Important Banks (GSIBs) account for approximately 66% of the assets held by all U.S. BHCs. *See* FIN. STABILITY OVERSIGHT COUNCIL, 2020 ANNUAL REP. 77–78 (Dec. 2020), https://perma.cc/TEU9-CH44. Specifically, Security Pacific National Bank, Rainier National Bank, First National Bank of Boston, and Bank of America National Trust & Savings Association are now all part of Bank of America Corporation; Mellon Bank and The Bank of New York are now part of Bank of New York-Mellon; Chase Manhattan Bank and Morgan Guarantee Trust Company are now part of JPMorgan Chase & Company; Citibank and Banamex are part of Citigroup; Crocker National Bank, Wachovia Bank & Trust Company, and Wells Fargo Bank are all part of Wells Fargo & Company; and Citigroup has acquired, among others, European American Bank. *See* Baker, *supra* note 219.

industry's focus shifted from forming new EACs to reorganizing within the BHC structure.[221]

As shown by Table 6, the average U.S. Globally Systemically Important Bank (GSIB) now accounts for hundreds of billions of dollars in cross-border claims and is comprised of hundreds—if not thousands—of unique legal entities that operate across dozens of jurisdictions.[222]

Table 6: U.S. GSIB International Footprints
Systemic importance indicators, Q2 2021

GSIB	Cross-border claims *($ billions)*	Legal entities	Jurisdictions
JPMorgan Chase	$1,100	937	56
Bank of America	$577	1,391	52
Citigroup	$1,161	976	96
Wells Fargo	$184	366	33
Goldman Sachs*	$644	3,617	51
Morgan Stanley*	$417	3,534	45
BNY Mellon	$156	708	41
State Street	$126	184	38
Total (Avg.)	**$546**	**1,464**	**52**

Source: Federal Reserve form FR Y-15, FFIEC's National Information Center
** = no EAC subsidiaries*

[221] The 2008 Global Financial Crisis (GFC), which was driven by many of the largest global banks, caused additional consolidation through the failures of smaller banks, a number of crisis-era mergers, and a dearth of new bank formations as a result of tepid economic growth and low-interest rate policies. *See* Robert M. Adams & Jacob Gramlich, *Where Are All the New Banks? The Role of Regulatory Burden in New Bank Formation*, 48 REV. INDUS. ORGS. 181, 182–83 (2016).

[222] GSIBs are large BHCs whose "failure . . . or . . . inability . . . to conduct regular course-of-business transactions, would likely impair financial intermediation or financial market functioning so as to inflict material damage on the broader economy" based upon a set of indicators established by an international body of financial regulators and implemented domestically. Bd. of Governors of the Fed. Rsrv. Sys., Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies, 79 Fed. Reg. 75473, 75475-77 (2014). For a comparison of 30 large international financial institutions, see GOVT. ACCOUNTABILITY OFF., BANKRUPTCY: COMPLEX FINANCIAL INSTITUTIONS AND INTERNATIONAL COORDINATION POSE CHALLENGES 36–37 (July 19, 2011), https://perma.cc/59ZG-845T.

While GSIBs' domestic commercial banking subsidiaries hold an average of 62% of their total consolidated assets, nonbanking entities comprise approximately 99.85% of their legal structures.[223]

Ironically, a law that was meant to break up a monopoly on international banking has instead resulted in an international banking oligopoly. As seen in Table 7, most GSIBs have maintained EAC subsidiaries to serve as hubs for their global operations. In particular, "[s]ome of the largest U.S. GSIBs still hold their foreign bank and broker-dealer investments through an [EAC] underneath their main bank, reflecting the traces of history when that was the only structure possible."[224]

Table 7: Vestiges of the Edge Act
EAC subsidiaries of U.S. GSIBs, Q2 2021

GSIB	Edge Corporation	State
JPMorgan Chase	JP Morgan International Finance Limited	Delaware
Bank of America	BankAmerica International Financial Corporation	California
Citigroup	Citibank Overseas Investment Corporation	Delaware
Wells Fargo	Wells Fargo International Banking Corporation	North Carolina
Goldman Sachs	--	N/A
Morgan Stanley	--	N/A
BNY Mellon	Mellon Overseas Investment	Delaware

[223] *See* Avraham, Selvaggi, and Vickery, *supra* note 213. Assets held under commercial banks can also be used for nonbanking activities through financial subsidiaries. *See* 12 U.S.C. § 24a. For an analysis of GSIBs' legal entities by type, see Steve Bright et al., *What Can We Learn from Publicly Available Data in Banks' Living Wills?*, 16-5 OFF. FIN. RES. BRIEF SERIES 1, 5 (May 25, 2016).

[224] BARR, JACKSON, AND TAHYAR, *supra* note 8, at 750. The exceptions are Goldman Sachs and Morgan Stanley, due to their historical status as investment banks that converted to BHCs on an emergency basis during the GFC.

	Corporation	
State Street	State Street International Holdings	Massachusetts

Source: FFIEC Nat'l Information Ctr.

Far from being obsolete, EACs evolved alongside the concentration and financialization that began in the 1980s and culminated with the passage of GLBA.[225]

2. Edge Corporations as Overseas Nonbank-Banks

EACs enjoy special legal status as overseas nonbank-banks. Nonbank-banks are "institutions that offer services similar to those of banks but which . . . conduct[] their business so as to place themselves arguably outside the narrow definition of 'bank'[.]"[226] Their *sui generis* treatment provides two advantages relative to traditional banks: (1) the ability to engage in more expansive nonbanking and nonfinancial activities; and (2) exemption from traditional structural restrictions, including the separation of banking and commerce.[227]

First, the Edge Act permits U.S. banks to engage in a wider range of activities abroad than those authorized domestically by GLBA, ostensibly in the name of competition.[228] The Fed updated Regulation K after the passage of GLBA, liberalizing EACs' permitted activities, providing greater latitude to operate without Fed approval, and relaxing solvency requirements and quantitative limits on investments.[229] Regulation K enumerates at least nineteen unique activities that EACs may engage in abroad.[230] In

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225 Taking one measure, from 1990 to 2016, banking industry assets grew from about $5.5 trillion to $19.5 trillion—an overall increase of 256%, or annual an average of about 5.2%. *See* Adams and Driscoll, *supra* note 220.

226 Bd. of Governors of the Fed. Rsrv. Sys. v. Dimension Financial Corp., 474 U.S. 361, 363 (1986).

227 *See id.* at 367. As noted above, they were also exempt from interstate branching restrictions, prior to their ultimate repeal. *See id.*

228 *See* Bd. of Governors of the Fed. Rsrv. Sys., International Banking Operations; Rules Regarding Delegation of Authority, 66 Fed. Reg. 54346, 54349 (Oct. 26, 2001).

229 *See id.* at 54346. For example, financial subsidiaries of banks were permitted to engage in any activity that a national bank could conduct directly, i.e., activities determined by Comptroller of the Currency to be part of or incidental to the "business of banking." *See* 12 U.S.C. § 24 (Seventh). They could also conduct most, but not all, of the financial and incidental activities expressly authorized by GLBA.

230 These activities include 16 different financial activities, such as traditional commercial, investment, trust and other banking activities; insurance brokerage and

addition, EACs are authorized by reference to engage in the nonbanking activities that the Fed has determined are "so closely related to banking" as to be a "proper incident thereto" under Regulation Y.[231] Regulation K also establishes the scope and conditions of the five categories of EACs' permissible investments.[232] Not limited to solely operating abroad, EACs may engage in at least seven different kinds of domestic banking and financing activities.[233] Finally, the Fed may also authorize an EAC

underwriting, including pensions and annuities; dealing, underwriting, and trading in securities, futures, swaps, commodities, and other products; and sponsoring investment funds and offering investment advice. 12 C.F.R. § 211.10(a). EACs are also authorized to participate in nonfinancial businesses, including data processing; management consulting services; and operating a travel agency in connection with financial services offered abroad. *Id.*

[231] *See* 12 C.F.R. § 211.10(b). The "laundry list" of incidental activities in Regulation Y includes 20 different financial activities and three nonfinancial activities. *See* 12 C.F.R. § 225.28(b).

[232] EACs may invest in: (1) foreign banks, branches and subsidiaries that engage in permissible financial activities; *as well as* (2) joint ventures; and (3) portfolio companies that engage in nonfinancial business. *See* 12 C.F.R. § 211.8(b), (c). In the latter case, such investments are subject to limits on both the amount of portfolio company shares that can be held and the amount of capital that can be put at risk. *See* 12 C.F.R. § 211.8(c)(3); *see also* 12 C.F.R. § 211.10(a)(15)(iii) (limiting an investing corporation to 40 percent of the total equity of a portfolio company and 19.9 percent of the voting shares of a portfolio company, and limiting investments to no more than 25% of tier 1 capital where the investor is a BHC and 20% of tier 1 capital where the investor is a member bank).

The Fed has interpreted the Edge Act to permit EACs to invest in foreign companies doing business inside the United States, so long as the foreign company is "engaged predominantly in business outside the United States or in internationally related activities in the United States," which requires more than a mere majority of its business be outside the U.S. 12 C.F.R. § 211.602. This interpretation is seemingly consistent with the BHCA, which authorizes the Fed to permit such investments by rule order if they would "not be substantially at variance with the purposes of [the BHCA] and would be in the public interest[.]" 12 U.S.C. § 1843(c)(13).

Finally, EACs are permitted to make equity investments pursuant to conversions of both sovereign and corporate debt in both private and public sector companies, subject to certain limitations. *See* 12 C.F.R. § 211.8(g)(1) (permitting an EAC to own up to 100 percent of the equity in such companies, but limiting an EAC's ownership of private sector companies to up to 40 percent of the shares and not more than 25 percent of the voting shares, and requiring the EAC's representation on the company's board of directors to be proportional to the ownership share, and also forbidding it from holding more than 50 percent of loans to such companies).

[233] Such activities include: (1) Taking certain deposits from foreign governments and entities, as well as certain deposits from U.S. entities related to foreign financing activity; (2) Borrowing from other EACs and foreign banking entities, from the U.S. government, and issue subordinated debt; (3) Credit activities, including financing imports and exports and production for such purposes, and offering debt and credit guarantees; (4) Engaging in payment and collection services, including accepting checks, bills, drafts, acceptances, notes, and bonds abroad and in the U.S. for customers abroad, wiring funds, and transferring securities; (5) Engaging in foreign exchange activities; (6) Providing fiduciary services and investment advising, largely related to foreign securities or activities; and (7) Providing banking services to employees. *See* 12 C.F.R. § 211.6(a).

to engage in activities that it determines are "incidental to [its] international or foreign business" or "usual in connection with the transaction of the business of banking or other financial operations abroad."[234] In all, EACs are authorized to conduct more than fifty different types of banking and nonbanking activities, as well as nonfinancial activities that commingle banking and commercial business.

The alternative to the Edge Act structure—the foreign branch—is more common and more closely tied to the operations of the parent bank.[235] With notice, banks, EACs, and nonbank affiliates within the BHC structure may establish foreign branches.[236] Branches can offer more limited services and engage in more limited activities than EACs. In addition to the general banking powers available to a parent bank, branches are permitted to engage in eight defined activities, as well as any other activities that the Fed determines are "usual in connection with the transaction of the business of banking" in the branch's host country.[237] U.S. banks are expected to "supervise and administer their foreign branches and subsidiaries in such a manner as to ensure that their operations conform to high standards of banking and financial prudence," including maintaining adequate recordkeeping and risk management practices.[238] Thus, while the process of opening and operating foreign branches is less legally onerous than for EACs, foreign branches are also more limited in their potential.

In addition to their broad activities, because EACs are not considered banks, they are exempt from a variety of banking laws that preserve the independence and stability of depository institutions.[239] Table 8 describes provisions from which EACs are exempt, including prohibitions against interlocking management,

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[234] 12 C.F.R. §§ 211.6(b), 211.10(c).

[235] *See* Houpt, *supra* note 206, at 600; *see also id.* at 603 (showing as of 1998, 49.9 percent of U.S. international banking assets were held in foreign branches).

[236] *See* 12 U.S.C. § 601; *see also* 12 C.F.R. § 211.3(b)(1), (5). Foreign branches must also "act if required to do so as fiscal agents of the United States." 12 U.S.C. § 601.

[237] 12 C.F.R. § 211.4. The permissible activities of a foreign branch include: (1) guarantees; (2) underwriting, buying, selling, and holding host country government securities; (3) investing in a range of other securities; (4) real estate lending; (5) insurance; (6) providing employee benefits programs; (7) engaging in repurchase agreements; and (8) making investments in subsidiaries. *See id.*

[238] 12 C.F.R. § 211.13(a)(1).

[239] CMTE. ON BANKING, HSG. & URBAN AFF, *supra* note 140, at 95–97. EACs fall into a category of financial institutions that "are subject to a similar, but not identical, set of regulations as federally-insured institutions, and as a result, may present greater risks [than federally-insured institutions]." Bd. of Governors of the Fed. Rsrv. Sys., Guidelines for Evaluating Account and Services Requests, 87 Fed. Reg. 51099, 51110 (Aug. 19, 2022).

limits on product cross-marketing, and credit concentration limits.[240] These provisions are important parts of a legal edifice erected to maintain the integrity, and prevent the misuse or abuse, of banks' special financing powers.

Table 8: EACs as Overseas Nonbank-Banks
EACs' banking law exemptions

Subject	Provision	Restriction
Interlocking management & directors	12 U.S.C. § 3204(2)	Prohibits officers and directors from serving at multiple banks simultaneously
Cross-marketing	12 U.S.C. § 1843(k), (n)	Prohibits banks from marketing products or services on behalf of companies, including commercial businesses, owned or controlled by merchant banking affiliates
Deposit insurance	12 U.S.C. §§ 1814-1818	Establishes minimum financial and managerial requirements for a depository institution to be eligible for deposit insurance
Affiliate transactions	12 U.S.C. §§ 371c & 371c-1	Establishes quantitative limits on transactions between banks and affiliates, and requires such transaction be on market terms
Credit exposures	12 U.S.C. § 84[241]	Limits unsecured and secured credit exposure to any one party to 15% and 25%, respectively, of a bank's capital
Dividend restrictions	12 U.S.C. §§ 56, 60[242]	Prohibits banks from paying dividends in excess of annual net income without regulatory approval, or when a bank does not experience an annual profit

240 In the absence of binding regulations, the Fed has sought to monitor credit exposures between parent companies and their Edge Act subsidiaries using the supervisory process. *See* Bd. of Governors of the Fed. Rsrv. Sys., Supervision and Regulation Letter 92-8: Advances by Banking Edge Corporations to Parent Institutions (Mar. 23, 1992), https://perma.cc/W5EP-5NQJ.

241 *See also* 12 C.F.R. § 32.1(c)(2)(iii).

242 The Federal Reserve Act extends these provisions to state member banks. *See* 12 U.S.C. § 324.

While EACs are not considered "banks" for purposes of these restrictions, they benefit from exclusions from securities registration and commodities trading regulations applicable to bank products, including loan participations and swap products.[243] Thus, EACs exist within a BHC structure and possess banking powers without being subject to the full range of obligations imposed upon banks and BHCs.

3. Containing Edge Corporations: Prudential Regulation and Supervision

In addressing the risks of international banking, Regulation K asserts that EACs should "at all times act in accordance with high standards of banking or financial prudence, having due regard for diversification of risks, suitable liquidity, and adequacy of capital."[244] An EAC must be "capitalized in an amount that is adequate in relation to the scope and character of its activities."[245]

Banking EACs have a minimum 10% capital-to-risk-weighted-assets ratio, and 5% ratio of tier 1 capital-to-risk-weighted-assets.[246] EACs are also subject to lending limits prohibiting them from financing trade acceptances in excess of 200% of their tier 1 capital or financing trade acceptances to a single borrower in excess of 10% of that capital.[247] Banking EACs generally may not lend more than 15% of their tier 1 capital to any single borrower.[248] However, credit extended by EACs is not combined with other bank transactions with the same borrowers for purposes of the National Bank Act's lending limits, because doing so "would put . . . banks at a competitive disadvantage in the foreign markets."[249]

EACs' investment activities are subject to escalating scrutiny—in the form of general consent, limited general consent, prior notice, or specific consent requirements—depending upon

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243 *See* 15 U.S.C. 78c(a)(4), (5); *see also* 7 U.S.C. §§ 27(a)–(b), 27a.

244 12 C.F.R. § 211.8(a).

245 12 C.F.R. § 211.12(c)(1).

246 *See* 12 C.F.R. § 211.12(c)(2). The previous requirement had been a minimum ratio of 7% of capital and surplus to risk assets. *See* 44 Fed. Reg., at 36,007.

247 Bankers acceptances are defined at 12 U.S.C. § 372, which also establishes a limit for most banks of not more than 150 percent of their capital.

248 *See* 12 C.F.R. § 211.12(a)–(b).

249 Ofc. of the Comptroller of the Currency, National Bank Lending Limits, 48 Fed. Reg. 15844, 15844–45 (1983). *See also* Joseph Jude Norton, *Being Competitive in a "Reregulated" Banking Environment: The Case of Commercial Lending Activities of Banking Institutions*, 11 OKLA. CITY U. L. REV. 547, 589 (1986).

their nature, size, and concentration.[250] In order to make investments, an EAC must meet total and tier 1 capital ratios of 8% and 4%, respectively.[251] EACs that are "well capitalized and well managed," with tier 1 and total risk-based capital ratios of 6% and 10%, respectively, are provided wider latitude.[252]

With regard to supervision, EACs occupy a "unique position, since they are regulated and supervised solely by the Federal Reserve, irrespective of the agency supervising the parent institution."[253] Regulation K requires U.S. banking organizations to "supervise and administer" foreign subsidiaries to "ensure that their operations conform to high standards of banking and financial prudence."[254] EACs must maintain reports regarding their activities and condition, including regarding joint ventures entered into by the EAC, and make such reports available to both management and examiners.[255] In general, the Fed is required to examine an EAC annually.[256] These examinations are conducted at the head offices of the U.S. banking organization.[257] The Fed's supervisory approach for each EAC should be tailored to the entity's activities, risk profile, and other attributes, according to a set of specific factors.[258] Examinations of an EAC's overseas operations must be conducted in coordination with the host country supervisor.[259] Historically, the supervisory process has helped reveal

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250 *See* 12 C.F.R. § 211.9.

251 *See* 12 C.F.R. § 211.9(a)(1).

252 *See* 12 C.F.R. §§ 211.2(y), 211.9(b).

253 GEN. ACCOUNTING OFF., STATUTORY REQUIREMENTS FOR EXAMINING INTERNATIONAL BANKING INSTITUTIONS NEED ATTENTION 6 (1984), https://perma.cc/3NVZ-NK8F.

254 12 C.F.R. § 211.13(a)(1).

255 *See* 12 C.F.R. § 211.13(a)(1)–(3). Examiners are also entitled to information regarding any organization the shares of which are held by an EAC. *See* 12 C.F.R. § 211.13(b).

256 *See* 12 C.F.R. § 211.13(b). The Fed may also order special examinations of foreign branches, banks, or corporations. Ironically, in the wake of the sovereign debt crises of the 1980s and the passage of ILSA, the GAO recommended that the annual examination requirement was no longer necessary because U.S. banks had "gained considerable experience in international banking," and therefore the "original level of scrutiny" was no longer needed. GEN. ACCOUNTING OFF, *supra* note 253, at 11. It also argued that the Fed lacked adequate resources to effectively supervise the number of EACs created in the wake of the IBA. *See id.* at 12–13.

257 *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., BANK HOLDING CO. SUPERVISION MANUAL § 2100.0.1 (2020).

258 *See* Bd. of Governors of the Fed. Rsrv. Sys., Supervision and Regulation Letter 08-9, Attachment A.1 (October 16, 2008, revised October 1, 2020), https://perma.cc/5ZWV-CKX5.

259 *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., BANK HOLDING CO. SUPERVISION MANUAL, *supra* note 256. The Basel Committee of Bank Supervision, an international coordinating body, has established joint principles for supervisory coordination between

some of the noncompliant, and potentially unsafe and unsound, EAC activities.[260]

GLBA required the Fed to defer "to the fullest extent possible" on reports and examinations conducted by a bank's primary supervisory agency.[261] Thus, if an EAC is a bank subsidiary, the primary regulator of the bank is the OCC, and the Fed largely defers to the OCC with respect to regulating that bank.[262] GLBA's proponents argued that functional regulation would "encourage and facilitate cooperation among the functional regulators," while reducing "overlap between the various regulators" and clearly allocating "responsibility and accountability for supervising the different parts of new financial holding companies."[263] To ensure effective enterprise-wide supervision, the Fed was to have a "meaningful, albeit streamlined, level of umbrella oversight of the entire organization."[264]

In practice, it is difficult for a single agency to acquire a complete picture of a banking conglomerate's global operations.[265] Under the balkanized U.S. regulatory structure, multiple agencies exercise either primary or backup supervisory authority, while home country and host country agencies share supervisory powers. With functional regulation and supervision of GSIBs being a virtual impossibility, the public supervision component of the public-private partnership has effectively been outsourced to private risk managers and "market discipline."[266]

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home and host countries with respect to international banking organizations. *See* Baxter and Freis, *supra* note 34, at 75–76.

260 *See* INTERVIEW WITH MICHAEL G. MARTINSON, *supra* note 153, at 58–60. (describing supervisors' discovery of risky real estate lending practices at EACs in Australia and Germany in the 1980s and 1990s).

261 12 U.S.C. § 1844(c)(2). The post-GFC financial reforms repealed provisions of GLBA that limited the Fed's ability to examine, obtain reports from, or take actions to identify or address risks for BHC subsidiaries that are supervised by other agencies. *See* Pub. L. No. 111-203, § 604, 124 Stat. 1375 (2010). At the same time, it required supervisors to, "to the fullest extent possible, avoid duplication of examination activities, reporting requirements, and requests for information." *Id.*

262 Until 1993, the Securities and Exchange Commission had supervisory responsibility for EACs' activities dealing government securities, but the Government Securities Reform Act amended the Securities Exchange Act of 1934 to cede this authority to the Fed. *See* S. REP. NO. 103-109, at 27 (1993); *see also* 15 U.S.C. § 78c(a)(34)(G)(ii).

263 Greenspan, *supra* note 216.

264 *Id.*

265 *See* Baxter & Freis, *supra* note 34, at 72.

266 *See* Joseph J. Norton, *A Perceived Trend in Modern International Financial Regulation: Increasing Reliance on a Public-Private Partnership*, 37 INT'L LAW. 43, 53–58 (2003).

B. International Banking in the Global Financial Crisis

Experiences such as the Asian currency crisis of the 1980s demonstrated that "a crisis in the domestic banking industry quickly can turn into an international economic crisis."[267] Like all financial crises, the GFC had many causes and implications, but it was undoubtedly a "global" crisis in its origins, in the cross-border contagion that exacerbated its impacts, and in the subsequent financial reform effort.

1. Living Globally, Dying Locally

Many of the risks of the GFC were produced by a deregulatory push motivated by the desire to promote U.S. banks as "national champions."[268] By 2007, London was a world financial capital, accounting for 35% and 43% of global banks' foreign exchange and derivatives activities, respectively.[269] This was due in no small part to the comparative laxity of the U.K. in the regulation of wholesale funding markets.[270]

In addition, the cross-border nature of modern financial markets and institutions created vulnerabilities that influenced governments' responses. The complexity and interconnections of the bankruptcy of the investment bank Lehman Brothers, including its overseas operations and derivatives business, risked igniting financial contagion.[271] U.S. regulators sought to save Lehman

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[267] Baxter and Freis, *supra* note 34, at 69; *see also* Testimony of Gary Gensler, Chairman of Commodity Futures Trading Comm'n, Before the S. Comm. on Bank., Hous. & Urb. Aff., 113th Cong. (Feb. 14, 2013), https://perma.cc/R8KL-RR6T ("During a default or crisis, risk knows no geographic border . . . if a run starts on one part of a modern financial institution, almost regardless of where it is around the globe, it invariably means a funding and liquidity crisis rapidly spreads and infects the entire consolidated financial entity.").

[268] *See* TOOZE, *supra* note 110, at 80–90.

[269] *See id.* at 81.

[270] *See id.* at 82. This dynamic culminated in disputes over derivatives contracts between the London offices of the investment bank Goldman Sachs and the insurance company AIG that helped stoke the GFC. *See* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 270–71 (2011).

[271] *See* FIN. CRISIS INQUIRY COMM'N, *supra* note 270, at 339–40 ("The [Lehman] bankruptcy affected about 8,000 subsidiaries and affiliates with $600 billion in assets and liabilities, the firm's more than 100,000 creditors, and about 26,000 employees. Its failure triggered default clauses in derivatives contracts, allowing its counterparties to have the option of seizing its collateral and terminating the contracts. After the parent company filed, about 80 insolvency proceedings of its subsidiaries in 18 foreign countries followed."); *see also* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292, 45294 (July 26, 2013) (finding that the subsidiary Lehman Brothers International Europe (LBIE) had an estimated 130,000 over-the-counter derivatives contracts, and there were over 300 debtor and creditor balances between LBIE and its affiliates representing $10.5B of receivables and $11.0B of payables).

Brothers by organizing a purchase by the U.K. bank Barclays, which U.K. regulators ultimately blocked, ostensibly to prevent the panic from spreading from the U.S. to Europe.[272] These events were a reminder that, as one former Fed policymaker observed, "while internationally active banks live globally, they may well die locally."[273]

The Fed's Primary Dealer Credit Facility program made loans to support the repo trades of U.K.-based subsidiaries of U.S. investment banks Goldman Sachs, Morgan Stanley, and Merrill Lynch, and the U.S. universal bank Citigroup.[274] U.S. banks also retrenched in their dollar-denominated lending to foreign banks, prompting the Fed to open currency swap lines with its foreign central bank counterparts.[275] In a refutation of the argument that global diversification provided financial stability benefits, banks' international operations and accompanying exposures emerged as a source of risk and instability.[276]

2. International Financial Reform: Dodd-Frank and Basel 3

Responding to the failures that contributed to the GFC, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). The law sought to reverse the prevailing deregulatory trend of the previous decades. While Dodd-Frank did not directly address U.S. banks' international activities, it had some effects on their overseas operations. Revised international financial regulatory agreements also sought to improve coordination across jurisdictions.

Attention to, and restrictions on, U.S. banks' foreign activities have long been animated by concerns that activities abroad will jeopardize banks' domestic solvency.[277] Because the GFC demonstrated that banks with significant foreign operations and intra-financial system liabilities are sources of contagion,[278] the post-GFC financial reforms established a system for safely

[272] *See* FIN. CRISIS INQUIRY COMM'N, *supra* note 270, at 335–37.

[273] Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Rsrv. Sys., Regulation of Foreign Banking Organizations 10, Remarks at the Yale School of Management Leaders Forum (Nov. 28, 2012).

[274] *See* James Felkerson, *$29,000,000,000,000: A Detailed Look at the Fed's Bailout by Funding Facility and Recipient* 18 (Levy Econ. Inst. Working Paper No. 698, 2011), https://perma.cc/H8PL-CR3U.

[275] *See* FIN. CRISIS INQUIRY COMM'N, *supra* note 270, at 275.

[276] *See* Baer & Colchester, *supra* note 216.

[277] *See* INTERVIEW WITH MICHAEL G. MARTINSON, *supra* note 153, at 3.

[278] *See* Meraj Allahrakha et al., *Systemic Importance Indicators for 33 U.S. Bank Holding Companies: An Overview of Recent Data* 15-01 OFF. FIN. RES. BRIEF SERIES 1, 6 (2015), https://perma.cc/ZBH2-4BYA.

resolving failures of large, complex financial institutions with cross-border businesses.[279] Title II of Dodd-Frank established an Orderly Liquidation Authority (OLA) for BHCs in the event that a normal bankruptcy proceeding would have significant adverse consequences for financial stability.[280] Under OLA, the FDIC is appointed receiver to liquidate the BHC, with losses borne first by shareholders and unsecured creditors.[281] Dodd-Frank states that "[n]o taxpayer funds shall be used to prevent the liquidation of any financial company under this title," and that "[t]axpayers shall bear no losses from the exercise of any authority under this title."[282] In order to facilitate the OLA process, Dodd-Frank requires large BHCs to file "resolution plans" with the Fed, explaining their plans for a "rapid and orderly resolution in the event of material financial distress or failure."[283] Resolution plans must include a list of all "material entities," including a hierarchical structure, exposures between legal entities, and practices regarding derivatives trading, booking, and collateral.[284]

Dodd-Frank also contained the "swaps push-out" provision. Section 716 of Dodd-Frank prohibited access to Fed lending and FDIC insurance or guarantees to entities that engage in certain derivatives trading—largely equity, credit, commodity, and other structured derivatives.[285] This was relevant to EACs' role as vehicles used by globally active U.S. banks to manage their derivatives book.[286] Echoing the justifications underlying the Edge Act, the IBA, and GLBA, opponents of this provision argued that it would "move overseas a lot of the [financial] products we do here and make it harder for Americans to be competitive—especially for financial services industries to be competitive—in the United States."[287] Though hotly contested during Dodd-Frank's

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[279] *See*, *e.g.*, Testimony of Governor Daniel K. Tarullo on International Cooperation to Modernize Financial Regulation Before the Subcomm. on Security and Int'l Trade & Fin., Comm. On Bank., Hous., & Urb. Aff., 111th Cong. (Sept. 30, 2009).

[280] *See* 12 U.S.C. § 5381 *et seq*.

[281] *See* 12 U.S.C. § 5384(a)–(b).

[282] 12 U.S.C. § 5394

[283] 12 U.S.C. § 5365(d).

[284] *See* 12 C.F.R. § 243.5(e).

[285] *See* Dodd-Frank Act, Pub. L. No. 111-203, tit. VII, § 716, 124 Stat. 2121 (2010). The provision's requirement that BHCs conduct certain classes of swaps activities out of separately capitalized affiliates, such as a broker-dealer, rather than their insured banks, gave rise to the provision's nickname. *See* John Crawford & Tim Karpoff, *The Swaps Push-out Rule: Much Ado About the Wrong Thing?*, 6 HARV. BUS. LAW REV. ONLINE 16 (2015).

[286] *See* Memorandum from Sullivan & Cromwell LLP, The Dodd-Frank 'Derivatives Push-Out' Does Not Apply to the Non-U.S. Operations of U.S. Banks 2 (Dec. 20, 2010), https://perma.cc/6EBM-7HVC [hereinafter Sullivan & Cromwell memo].

[287] 156 CONG. REC. at S5890 (daily ed. July 14, 2010) (statement of Sen. Gregg).

legislative process and after its passage, the swaps push-out's effect on EACs was largely underappreciated.

GSIBs, however, were aware of the importance of EACs as vehicles for derivatives dealing. Shortly after Dodd-Frank's passage, counsel representing Citigroup argued that the swaps push-out did not apply to EACs because they do business overseas and, as nonbank-banks, are not the type of insured depositories contemplated by the provision.[288] This issue was largely mooted in December 2014, when Congress included a provision in its annual appropriations bill that significantly narrowed the swaps push-out provision.[289] As a result, policymakers and BHCs avoided confronting whether banks' overseas subsidiaries should be prohibited from engaging in risky derivatives transactions.

In addition to Dodd-Frank, U.S. bank regulators reached a post-GFC agreement with their international counterparts to harmonize bank capital regulation. The Basel III International Capital Accord sought to "improve the quality and quantity of regulatory capital and build additional capacity into the banking system to absorb losses in times of market and economic stress" and to set consistent standards across legal jurisdictions.[290] While not directly applicable to EACs, under the Basel III rules, banks and BHCs that exceed a threshold of international activity are subject to heightened capital standards.[291] Thus, post-GFC financial reforms tangentially addressed the role of U.S. banks in the global financial order.

[288] *See* Sullivan & Cromwell memo, *supra* note 286. In fact, the lawyers argued that EACs must be exempted from this provision expressly so that banks could set up Edge Act affiliates into which they could move their derivatives in a maneuver that would comply with the letter, if not the spirit, of the push-out provision. *See id.* at 16–17.

[289] *See* Crawford & Karpoff, *supra* note 285. Prior to the provision's enactment, there were media reports that Citigroup lobbyists had a hand in drafting the legislative provision that eventually became law. *See* Eric Lipton & Ben Protess, *Banks' Lobbyists Help in Drafting Financial Bills*, N.Y. TIMES (May 23, 2013), https://perma.cc/L2X6-JQ8K.

[290] Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 Fed. Reg. 62018, 62021 (Oct. 11, 2013).

[291] *See id.*, at 62143–44; *see also* 12 C.F.R. § 217.1(c). Global Systemically Important Banks (GSIBs) are also subject to a capital surcharge, the calculation of which includes cross-jurisdictional activity as a factor. *See* Implementation of Risk-based Capital Surcharges for Global Systemically Important Bank Holding Companies, 80 Fed. Reg. 49082 (Aug. 14, 2015).

C. Modern Edge Corporations: Three Case Studies

As memories of the GFC faded, the argument that there are tradeoffs between robust regulation and competitiveness re-emerged. The pendulum had swung too far, some argued, and the competitiveness of U.S. banks was again at risk.[292] In fact, U.S. banks largely out-competed their European and other international counterparts during this period, particularly in investment banking.[293] Far from a hindrance, the regulations imposed after the GFC were cited as a source of strength that enabled U.S. banks to capture market share from foreign competitors.[294]

During the trade expansion period of the 1950s and 1960s, EACs' loans and equity investments had been focused on industrial concerns;[295] in the 1970s ship lending was a major focus.[296] Instead of promoting U.S. exports by enabling private sector financing, the modern Edge Act and other policies have focused on

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292 *See* Exec. Order No. 13,772, 82 Fed. Reg. 9,965 (Feb. 8, 2017) (declaring a policy that financial regulation should "enable American companies to be competitive with foreign firms in domestic and foreign markets" and be "efficient, effective, and appropriately tailored"); *see also* Margin and Capital Requirements for Covered Swap Entities, 84 Fed. Reg. 59970, 59976 (Nov. 7, 2019) (stating that certain margin requirements for derivatives transactions between banks and their affiliates may "put U.S. banking firms at a competitive disadvantage"); *see also* Tom Braithwaite et al., *Banks Anxious Over Fed Regulations*, FIN. TIMES (May 3, 2011), https://perma.cc/DKM5-YZGH ("One senior official accused banks of trying to lobby for softer rules in Europe with the aim of persuading the U.S. to soften its proposals to avoid an unlevel playing field.").

293 *See* Joseph Otting, *The Return from the Brink and the Rise of Banks in the United States*, INT'L BANKER (Nov. 26, 2019), https://perma.cc/HW9E-LDHY (noting that "banks in the United States have flexed their competitive muscle," earning 62% of global investment fees, 70% of merger fees, and 60% of stock commissions in 2018); *see also* Simon Clark, *U.K. Looks to Compete on Financial Regulation*, WALL ST. J. (Nov. 27, 2021), https://perma.cc/Z2FC-QSXC.

294 *See*, *e.g.*, Martin Arnold, *How U.S. Banks Took Over the Financial World*, FIN. TIMES (Sept. 18, 2018), https://perma.cc/3BGL-5RKX; *see also* Justin Baer & Max Colchester, *U.S. Banks Take Global Lead*, WALL ST. J. (July 30, 2015), https://perma.cc/8AHF-G9VG; *see also* Editorial, *Banking and Nothingness*, THE ECONOMIST (Oct. 17, 2015), https://perma.cc/H6LD-WBMR. Demonstrating the counterintuitive logic of the "race-to-the-bottom" dynamic, the loss of market share from 2018–2020 prompted the U.K. government to announce that it was prioritizing "international competitiveness" in its financial regulations. *See* Clark, *supra* note 293. Financial regulators raised objections, however, noting that robust financial regulation is an important foundation for growth and competitiveness. *See* Sam Woods, Deputy Governor for Prudential Regulation, Bank of England, Speech at Mansion House: Growth and Competitiveness (Oct. 27, 2022), https://perma.cc/TJ5X-8TF7.

295 As of 1964, loans and equity financing of EACs covered manufacturing, mining, and service industries and, to a lesser extent, public utilities. *See* Bossy, *supra* note 111, at 90–91. Manufacturing concerns financed included "concrete products from cement, chemicals based on oil, paper mills, cotton textile mills, and even steel mills where there is coal and iron ore." *Id.*

296 *See* INTERVIEW WITH MICHAEL G. MARTINSON, *supra* note 153, at 7.

ensuring the competitiveness of U.S. finance as an end in itself. The U.S. went from being a net exporter in the 1960s to incurring persistent annual trade deficits of hundreds of billions of dollars.[297] While this trend cannot be attributed solely to financial laws, they are one contributing factor, as financial liberalization and deregulation played an important role in a broader economic policy agenda.

As should be clear, private credit and deregulation have been ineffective means of promoting industrial growth, making it difficult to characterize the Edge Act as anything other than a failure on its own terms. Today, EACs have largely become concentrated among a few giant banking conglomerates for the purposes of trading financial instruments, as illustrated by the following three examples: (1) JPMorgan Whitefriars; (2) Citigroup Overseas Investment Corporation; and (3) CLS Bank.

1. JPMorgan Whitefriars

JPMorgan Chase & Co.'s EAC illustrates how U.S. banking abroad has evolved in the modern financial era. As of 1971, Chase International Investment Corporation, an EAC owned and controlled by a predecessor institution, was invested in overseas economic development projects: a rice producer in Costa Rica, a toll road in Spain, and a fertilizer plant in Australia.[298] Over the course of the next few decades, pursuant to the trend of financial modernization, Chase's EAC transformed from an investment vehicle for industrial development to a booking entity for opaque and complex financial products.

The London Whale exemplifies JPMorgan's evolution. J.P. Morgan International Finance, Limited (JPMIFL) is JPMorgan Chase's EAC. J.P. Morgan Whitefriars, Inc., is a subsidiary of JPMIFL, and its longstanding London subsidiary, J.P. Morgan Whitefriars, U.K., is described by the company as the legal entity "where risk positions are booked for certain businesses of the Corporate & Investment Bank through its London Branch."[299] The "Whale trades" that came to light in 2013 originated from the

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[297] *See* BUREAU OF ECON. ANALYSIS, U.S. INTERNATIONAL TRADE IN GOODS AND SERVICES, tbl. 1 (Aug. 2022), https://perma.cc/R9CX-HNPP.

[298] *See* McGuire, *supra* note 37, at 440.

[299] JPMORGAN CHASE & CO., RESOLUTION PLAN PUBLIC FILING 12 (July 1, 2015); *see also* JPMORGAN CHASE & CO., RESOLUTION PLAN PUBLIC FILING 4 (2012) ("J.P. Morgan Whitefriars Inc. is a Delaware company that, through its London Branch, acts as the Firm's primary legal entity to book and manage certain equity and credit security and derivative products.").

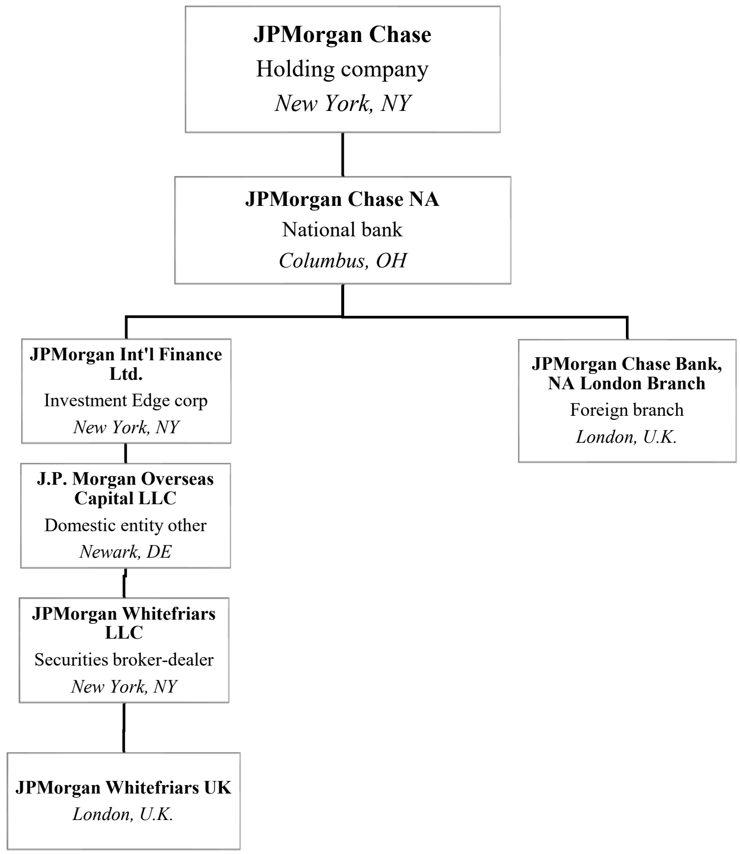
Chief Investment Office (CIO), a unit inside J.P. Morgan Chase's national bank designed to manage the firm's risk by creating an investment portfolio to both offset risks in the bank's other divisions and to earn additional profits by investing "excess" deposits.[300] The CIO is in New York, but the unit responsible for the losses was based in the London branch of JPMorgan Chase NA, the national bank.[301] While the London Whale worked for the CIO, consistent with the company's description above, the "Whale trades" were then transferred and booked in JPMorgan Whitefriars U.K.[302] Figure 1 documents this complicated chain of relationships.

300 *See* OFC. OF THE INSPECTOR GEN., *supra* note 6, at 16.

301 *See id.* at 14.

302 *See id.*; *see also id.* at 47 ("The CIO ultimately booked its synthetic credit derivatives transactions in Whitefriars, a subsidiary of an Edge Act corporation within JPMC Bank, N.A."). The decision about which legal entity in which to book trades is generally influenced by both tax rules and financial regulations. *See* Houpt, *supra* note 181, at 605.

Figure 1: Organizational Mechanics of J.P. Morgan's London Whale Trades



Source: FFIEC's National Information Center, Federal Reserve Inspector General,
JPMorgan Chase & Co. form 10-k

Importantly, the EAC was able to hold noninvestment grade corporate credit derivatives that are impermissible for banks to own directly.[303] This derivatives portfolio, executed by the CIO and booked at the EAC, grew as large as $157 billion.[304] When the traders in the CIO sought to unwind their trades, they did so not by selling off their positions but instead by purchasing additional credit protection against the underlying positions, increasing the

[303] *See* OFF. OF INSPECTOR GEN., *supra* note 6; *see also* 12 C.F.R. §§ 1.2–1.3.
[304] *See* OFF. OF INSPECTOR GEN., *supra* note 6, at 32.

size of the overall portfolio.[305] At the same time, the OCC's oversight of the CIO as the lead supervisor of the national bank and the Fed's role as the supervisor of Whitefriars, the EAC, were lacking.[306] Ultimately, the size of these positions, and their illiquidity, meant that JPMorgan was unable to unwind its positions in order to avoid losses as markets began to move against its trades. The company lost more than $6 billion on the trades, and paid hundreds of millions of dollars in fines for failing to effectively oversee its traders.[307]

Notwithstanding the role of the Edge Act in this episode, there were no calls to reform the law. To the contrary, just a short time later, Congress all but repealed the swaps push-out provision, which may have required J.P. Morgan Chase to move the London Whale trades, and other derivatives, from its CIO to a non-taxpayer-backed legal entity. [308]

2. Citigroup Overseas Investment Corporation

With the most cross-border claims and a presence in the most jurisdictions, Citigroup is arguably the most internationally active U.S. GSIB. Citigroup derives a significant portion of its revenues from its overseas operations.[309] At the same time, many of Citigroup's international businesses have operated on a "decentralized, quasi-independent basis," using "multiple data processing systems that were not compatible and did not communicate with each other."[310] Citigroup's EAC, Citibank Overseas Investment Corporation (COIC), is the "most central firm" within Citigroup's network of legal entities.[311] As Figure 2 illustrates, with 247 legal subsidiaries in 48 different jurisdictions, COIC is

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305 *See id.*

306 *See id.* at 35–48. It should also be noted that the costs of maintaining the London subsidiary of Whitefriars may have come to exceed its benefits, as public information suggests that JPMorgan liquidated the legal entity Whitefriars U.K. in 2017. J.P. Morgan Whitefriars Liquidation Notice, THE LONDON GAZETTE, June 26, 2017, at 12306, 12309 & 12312 (Issue No. 61976), https://perma.cc/8FUK-JQJW (announcing voluntary liquidation, providing notice to creditors, and announcing passage of resolutions for voluntary wind-up).

307 *See supra* notes 1–7 and accompanying text.

308 *See supra* notes 285–89 and accompanying text.

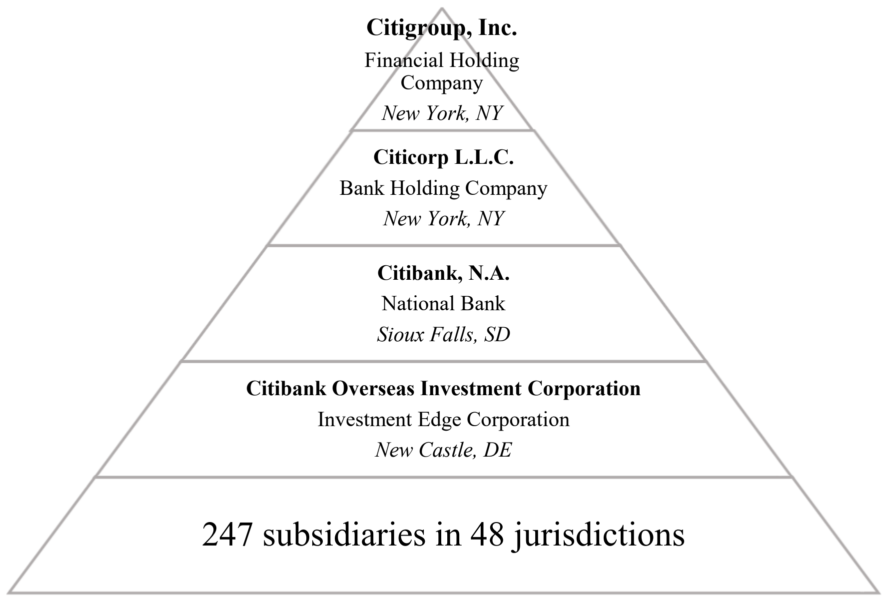
309 *See* CITIGROUP, 2019 RESOLUTION PLAN PUBLIC (2019) [hereinafter "CITIGROUP RESOLUTION PLAN"], https://perma.cc/GXL8-4DW5 (stating that as of 2019, 48% of Citigroup's assets and more than half of Citigroup's revenue and income came from banking operations outside of North America).

310 Arthur E. Wilmarth, Jr., *Citigroup: A Case Study in Managerial and Regulatory Failures*, 47 IND. L. REV. 69, 119 (2013).

311 Jeremy D. Oldfather, Stefan Gissler & Doriana Ruffino, *Bank Complexity: Is Size Everything?*, FEDS NOTES (July 15, 2016), https://perma.cc/J2NK-VSEN.

by far the most organizationally complex of the EACs owned by the four largest U.S. GSIBs.[312] COIC alone has more legal subsidiaries and cross-border exposure than most large U.S. BHCs.

Figure 2: Citigroup's legal structure



Source: FFIEC's National Information Center

During the GFC, COIC operated twenty foreign banks around the world.[313] At the time, COIC held $497 billion in assets, comprising 24% of the total consolidated assets of Citigroup and 24% of the assets of Citibank, NA, the insured bank.[314] Chief among the concerns about Citigroup's systemic risk were its derivatives exposures and its approximately $500 billion in foreign deposits.[315] At the onset of the crisis, U.K. authorities imposed a

[312] Some number of these may be special-purpose corporations which EACs are permitted to establish "for the purpose of engaging in a particular transaction involving the financing of one or more items of personal property or equipment and a single customer purpose of engaging in a particular transaction, rather than a general business." 59 FED. RES. BULL. 104 (Feb. 1973).

[313] FED. DEPOSIT INS. CORP., SYSTEMIC RISK DETERMINATION MEMORANDUM TO THE BOARD OF DIRECTORS 5 (Nov. 23, 2008), https://perma.cc/Q3K3-GSL6.

[314] *See* SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, EXTRAORDINARY FINANCIAL ASSISTANCE PROVIDED TO CITIGROUP, INC. 58 (Jan. 13, 2011), https://perma.cc/XZ3B-FMV6.

[315] *See id.* at 14–15.

$6.4 billion cash "lockup" to preserve the liquidity of Citigroup's London-based broker-dealer, effectively trapping the funds overseas.[316] As a result, the U.S. government provided Citigroup with $45 billion in capital, guaranteed up to $301 billion of its assets,[317] and the Fed's Primary Dealer Credit Facility provided loans to its U.K. affiliate.[318]

The GFC experience was not Citigroup's only challenging international banking experience. It has dealt with shortcomings in money laundering compliance within its Mexican banking subsidiary.[319] It is also the GSIB with the most financial exposure to the Russian economy during the invasion of Ukraine,[320] causing it to experience the greatest impact from the international sanctions regime. Citi provides a dramatic example of the potential risks of global ambition.[321]

3. CLS Bank

CLS Bank is an anomaly in the banking world. After the Herstatt episode and subsequent failures of internationally active financial companies including BCCI and Drexel Burnham in 1990, and Barings Bank in 1995, policymakers grew concerned about global financial institutions' mismanagement of foreign exchange risk.[322] The result was the creation of CLS Bank, which

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316 *See* FIN. CRISIS INQUIRY COMM'N, *supra* note 270, at 380.

317 *See* SPECIAL INSPECTOR GEN. FOR TROUBLED ASSET RELIEF PROGRAM, *supra* note 309, at 28, 32.

318 *See* Felkerson, *supra* note 274, at 18–19.

319 In 2017, Citigroup was cited by the DOJ for money laundering violations at its Mexican subsidiary Banamex, was required to pay a $97 million fine, and entered into a non-prosecution agreement. *See* Non-Prosecution Letter from Deborah Connor, Acting Chief, Money Laundering & Asset Recovery Section, U.S. Dep't of Just., to Brad S. Karp and Susanna Buergel, (May 18, 2017), https://perma.cc/3QA5-X5LR. Citigroup acquired Banamex in 2001, including an EAC that Banamex had established in 1988. *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., ORDER APPROVING ACQUISITION OF A BANK HOLDING COMPANY, (July 16, 2001), https://perma.cc/5PM8-UBZW; *see also* Banamex International: Corporation to do Business Under Section 24(a) of the Federal Reserve Act, 53 Fed. Reg. 52488 (Dec. 28, 1988).

320 *See* Citigroup Inc., Annual Report (Form 10-K) 121 (Feb. 28, 2022) (reporting that Citigroup had $9.8 billion in exposures to the Russian economy at the time of Russia's invasion of Ukraine); David Benoit, *Citigroup has Nearly $10 billion in Total Russian Exposure*, WALL ST. J. (Feb. 28, 2022).

321 For a thorough analysis of Citi's history of risk management failures, see Wilmarth, *supra* note 310.

322 *See* BANK FOR INT'L SETTLEMENTS, SETTLEMENT RISK IN FOREIGN EXCHANGE TRANSACTIONS (Mar. 1996), https://perma.cc/LQ53-UHXJ. Note that these concerns preceded the foreign exchange-driven failure of LTCM by about two years.

"operate[s] a global network that facilitates currency transactions."[323] CLS is a "'user-owned' financial market utility used to mitigate settlement risk through a combination of payment versus payment in central bank money, multilateral payment netting, and a standard legal framework."[324]

CLS Bank International is a New York EAC, and a wholly owned subsidiary of CLS Services Ltd., a London corporation.[325] In addition to its EAC supervision, the Fed has authority over CLS resulting from its status as a systemically important financial market utility.[326] CLS is also subject to a Cooperative

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323 Alice Corp. Pty. Ltd. v. CLS Bank Int'l, 573 U.S. 208, 208, 214 (2014). CLS is an acronym for "continuous linked settlement." In 2020, CLS settled an average daily volume of more than 1 trillion transactions worth $5 trillion, with a peak daily volume of more than $13 trillion and more than 2.6 million transactions. *See* CLS GRP. HOLDINGS AG, ANNUAL REP. AND CONSOLIDATED ACCOUNTS 9 (Dec. 31, 2020), https://perma.cc/MB4B-9QN5 [hereinafter CLS ANNUAL REPORT]. As of 2020, CLS facilitated the trading of 18 currencies, on behalf of 74 members, with 25,000 unique third-party participants. *See id.* at 6, 9.

324 BANK OF AM., BANK OF AM. CORP. RESOLUTION PLAN, PUBLIC EXECUTIVE SUMMARY 26–27 (2012), https://perma.cc/AL7C-P6XC. CLS uses a system of payment-versus-payment, wherein both sides of foreign exchange transactions are periodically grossed, settled and funded; pay-outs are made only if and when a party has made its required pay-in of any outstanding amounts. *See* Darrell Duffie, *Replumbing Our Financial System: Uneven Progress*, 9 INT. J. CENT. BANK. 251, 267 (2013); *see also Alice Corp.*, 573 U.S. at 212–14. CLS allocates any funding shortfalls to its members and maintains access to a liquidity facility for any potential funding needs. These practices apply to, for example, foreign exchange forwards, foreign exchange options, and derivatives.

325 *See* De Novo Corporation to Do Business Under Section 25A of the Federal Reserve Act, 64 Fed. Reg. 44735 (Aug. 17, 1999). The CLS organization includes: (1) CLS Group Holdings, the group holding company incorporated under the laws of Switzerland and regulated by the Fed as if it were a BHC in the U.S.; (2) CLS UK Intermediate Holdings, a limited company incorporated under the laws of England and Wales, effectively a 'shell' company from a governance perspective, which provides corporate services (i.e., Finance, Human Resources, Audit and Communications) to CLS Bank and its affiliated companies; (3) CLS Bank, an EAC organized under the laws of the U.S. and regulated by the Fed; and (4) CLS Services, a limited company incorporated under laws of England and Wales, which provides operational and back-office support to CLS Bank and its affiliated companies. *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., PROTOCOL FOR THE COOPERATIVE OVERSIGHT ARRANGEMENT OF CLS (Dec. 10, 2015), https://perma.cc/7GT9-2SPG [hereinafter PCOA].

326 12 U.S.C. §§ 5463, 5464. The Financial Stability Oversight Council is a multi-agency council chaired by the Secretary of the Treasury and tasked with identifying emerging systemic risks and providing for their comprehensive regulation. Financial market utility (FMU) designations are based upon factors including transactions, exposures, interdependencies, and the effect of any failure or disruption on critical markets, financial institutions, or the financial system. *See* Authority to Designate Financial Market Utilities as Systemically Important, 76 Fed. Reg. 44763, 44764 (July 27, 2011). In July 2012, the eight FMUs were designated as systemically important. *See* Press Release, Dep't of the Treasury, Financial Stability Oversight Council Makes First Designations in Effort to Protect Against Future Financial Crises (July 18, 2012), https://perma.cc/58DZ-RZF5. Systemically important FMUs are subject to risk management standards that promote safety and soundness, reduce systemic risks, and support the stability of the financial system,

Oversight Arrangement (COA) between the central banks whose currencies CLS is authorized to settle. The goals of the COA include coordinating supervision and oversight of CLS, ensuring consistency, eliminating gaps, and reducing overlap.[327] The Fed is both the primary supervisor of CLS as well as the head of CLS's Oversight Committee,[328] a multilateral coordinating body comprised of a group of central banks.[329]

Thus, the Edge Act provides a framework for operating a settlement service for foreign exchange transactions that is mutually owned by the largest financial institutions in the world who are also the largest users of its services.[330] There are at least three layers of regulation and supervision around CLS: (1) domestically, in its capacity as an EAC and BHC; (2) also domestically, in its capacity as a designated financial market utility; and (3) internationally, in its capacity as a settlement system for foreign currencies with access to multiple central bank accounts.[331]

which include margin and collateral requirements as well as capital requirements. *See* 12 U.S.C. § 5464(b)–(c). The Fed's rules interpreting these risk management standards relate to efficiency, access, and governance standards for payment systems, central counterparties, and central securities depositories. *See* Designated Financial Market Utilities, 12 C.F.R. § 234.

327 *See* PCOA, *supra* note 325, at 2–3.

328 *See id.*, at 3–4.

329 The Fed and relevant central banks consult on, and have the power to deny, any proposal by CLS to settle a new currency. *See id.* at 4–5. The Fed is also entitled to review any proposed policy or rules changes. *See id.* at 5–6.

330 According to CLS, no single entity holds more than a 4.8% ownership stake. *See* CLS ANNUAL REPORT, *supra* note 323, at 79. There is some precedent for banks using the Edge Act as a vehicle to form joint venture corporations to facilitate their international activities. *See* JOINT ECON. COMM., *supra* note 37, at 177–78 (noting the example of Allied Bank International, a joint venture EAC between 18 U.S. banks). Relevant to the CLS example, the mutualized ownership structure of payment, clearing and settlement services forces competitors to work in coordination to efficiently allocate payments, verify transactions, and mutualize risk, and therefore requires tight regulation to preserve competitive markets and standards of fair dealing. *See* Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Rsrv. Sys., Remarks at the Conference on Regulating Systemic Risk, *Industrial Organization and Systemic Risk: An Agenda for Further Research* 8 (Sept. 15, 2011), https://perma.cc/5C45-4ALP. As a result, the Fed has imposed open access rules that are meant to address issues of concentration, financial stability, and "too big to fail" (TBTF), serving as an important "first line of defense" in mitigating financial risk. Financial Market Utilities, Designated Financial Market Utilities, 12 C.F.R. § 234; *see also* Financial Market Utilities, 77 Fed. Reg. 45907, 45907–10 (Aug. 2, 2012).

331 Designated payment and clearing systems are also entitled to maintain master accounts at the Fed, and the Fed may exempt a designated company from its reserve requirements. *See* 12 U.S.C. § 5465(a).

IV. WHERE WE'RE GOING: THE ERA OF DIGITIZATION

In the past, U.S. banks' global operations manifested risks related to sovereign debt, money laundering, and derivatives trading. Today, GSIBs' global reach implicates other emerging risks. One such example is geopolitical risk, as demonstrated by the sanctions regimes imposed in response to Russia's invasion of Ukraine.[332] U.S. banks' dominant global position has made them a transmission channel for governments seeking to punish their adversaries by foreclosing access to the international banking system. This interconnectedness exposes GSIBs to the costs of implementing economic sanctions, as well as to cyberattacks by enemy nations and their affiliates.[333]

Located beyond the legal "shores" of the U.S., EACs operate with greater legal flexibility than traditionally permitted under the domestic banking regulation and supervision regime. One could argue that the Edge Act has become obsolete post-GLBA, as U.S. banks are permitted to engage in a wide range of financial activities domestically. This view is shortsighted. The nonbank-bank EACs offer several advantages over alternative nonbank subsidiaries. As a result, they are likely to remain attractive to U.S. BHCs, and the transition of financial services to a largely digitally based industry should only further their appeal.[334] International reforms targeting foreign branches should also incentivize the use of non-branch structures.[335]

Indeed, some GSIBs are recommitting to the Edge Act model. JPMorgan has created an overseas digital bank to serve retail customers in the UK and EU.[336] The bank is expanding its overseas footprint due to the "massive digital disruption happening around the world" that "opens up a window of opportunity" for the

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332 *See supra* notes 16–18.

333 *See supra* note 19; *see also* Lananh Nguyen & Stacy Cowley, *Wall Street Profits Slump as War Weighs on Outlook*, N.Y. TIMES (Apr. 14, 2022), https://perma.cc/S4NN-95TC.

334 *See* U.S. DEPT. OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: NONBANK FINANCIALS, FINTECH, AND INNOVATION 17–19 (2018), https://perma.cc/M4V8-KERZ (discussing the digitization of financial services).

335 For example, the European Commission has proposed legislation to harmonize and increase prudential and other standards applicable to European Union branches of non-EU banks. *See Commission Proposal for a Directive of the European Parliament and of the Council Amending Directive 2013/13/EU As Regards Supervisory Powers, Sanctions, Third-Country Branches, and Environmental, Social and Governance Risks*, at 10–19, COM (2021) 663 final (Oct. 27, 2021); *see also id.* at Title VI.

336 *See* Press Release, JPMorgan Chase & Co., JPMorgan Chase to Launch Digital Consumer Banking in the U.K. (Jan. 27, 2021), https://perma.cc/37MG-T3GR.

bank.[337] This new digital bank operates as a subsidiary of its EAC, JPMIFL.[338] As they attempt to capitalize on these opportunities, GSIBs also have the potential to generate new risks during the digital era, using the Edge Act as their conduit.

A. Over the Edge: The Risks of Edge Banking

Five aspects of EACs' *sui generis* legal treatment are likely to be of particular relevance going forward: (1) their potential utility in the growing digital asset markets; (2) their exemption from restrictions on affiliate transactions; (3) their permissive capital treatment; (4) their exemption from structural separations; and (5) their role in the process for resolving failing BHCs. The following discussion of these risks will help in evaluating whether the benefits of this legal anomaly outweigh its costs, and ultimately demonstrates that the Edge Act framework for regulating international financial conglomerates is an anachronism in need of reform.

1. Digital Assets

The growth of digital assets like cryptocurrencies raises fundamental questions about the intersection of globalization and financialization. As financial markets grow increasingly abstract and self-referential, it is increasingly difficult to draw meaningful boundaries between the realms of "national" and "international." Digital-era financial services extend and intensify these trends in important ways. First, digital asset markets are effectively stateless, operating on blockchains and other systems housed on computer servers scattered across the globe and exchanges often registered offshore.[339] Second, there has been a growth in nonbank-bank entities in the digital asset ecosystem seeking to conduct

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337 Joshua Franklin, *JPMorgan Warns Overseas Digital Bank Losses Could Top $1bn After UK Push*, FIN. TIMES (May 23, 2022), https://perma.cc/4APG-RA9K.

338 Specifically, the digital bank operates through J.P. Morgan Europe Limited (JPMEL). *See* JPMorgan Chase & Co., Annual Report (Form 10-K) 6 (Feb. 22, 2022), https://perma.cc/TP6H-B69Y. According to FFIEC database information, JPMEL is a subsidiary of J.P. Morgan Capital Holdings Limited, which is a subsidiary of JPMIFL. *See* NAT'L INFO. CTR., FEDERAL FIN. INSTITUTION EXAMINATION COUNCIL, J.P. MORGAN CHASE & CO. ORGANIZATIONAL HIERARCHY, https://perma.cc/8VUA-X5UE (last visited Nov. 6, 2021).

339 The cryptocurrency exchange company Bitfinex is incorporated in the British Virgin Islands, the crypto exchange company Tidex is incorporated in the Cayman Islands, and the cryptocurrency exchange company Binance "reportedly moved its operations to Malta, after initially locating in Taiwan and then Japan." OFF. OF THE N.Y. STATE ATT'Y GEN., VIRTUAL MARKETS INTEGRITY INITIATIVE REPORT 8 (Sept. 18, 2018), https://perma.cc/FZ5J-AST2.

bank-like activities without commensurate regulation. Finally, digital asset industry supporters have promoted these financial instruments using competition arguments that mirror those made in service of deregulating U.S. banks' overseas activities.[340] In this context as well, there is little evidence that regulation causes financial services activities to migrate across jurisdictions.[341]

EACs' nonbank-bank structure satisfies important components of the digital asset project, namely legal malleability and circumvention of traditional banking and securities regulation.[342] Digital asset firms generally seek the privileges of banking without the full suite of accompanying obligations and limitations.[343] As discussed, both above and below, EACs' nonbank-bank structure does not trigger classification of its parent as a BHC, and thus the BHCA's accompanying rules regarding "control" and insider and affiliate transaction restrictions do not apply. This means that parties in the digital asset ecosystem, including exchanges, so-called "DeFi" platforms, and venture capital funds investing in crypto companies, could establish EACs to engage in digital asset activities without being subject to the full suite of rules that apply to entities engaged in the business of banking.[344]

340 *See* Jelena McWilliams, Chairman, Fed. Deposit Ins. Corp., Remarks at Money 20/20 (Oct. 27, 2021), https://perma.cc/4SWT-FKLN (arguing that U.S. policymakers should be "cognizant that our American values, culture, and influence face increasing competition from abroad, including from regulatory systems that focus intently on promoting technological innovation and taking the mantle from the United States").

341 *See* Brian D. Feinstein & Kevin Werbach, *The Impact of Cryptocurrency Regulation on Trading Markets*, 7 J. FIN. REG. 48 (2021).

342 *See* Saule T. Omarova, *Dealing with Disruption: Emerging Approaches to Fintech Regulation*, 61 WASH. U. J.L. & POL'Y 25, 34 (2020) ("[M]any recent innovations in finance are designed specifically to overcome traditional regulatory boundaries . . . ."). Companies providing digital asset services have also registered as national trust banks, another form of nonbank-bank charter. *See*, *e.g.*, Letter from Stephen A. Lybarger, Deputy Comptroller Licensing, Off. of the Comptroller of the Currency, to Nathan McCauley, President & Dir., Anchorage Trust Company, Application by Anchorage Trust Company, Sioux Falls, South Dakota to Convert to a National Trust Bank (Jan. 13, 2021), https://perma.cc/77GR-PHXS.

343 *See*, *e.g.*, Lev Menand & Morgan Ricks, *Federal Corporate Law and the Business of Banking*, 88 U. CHI. L. REV. 1361, 1409–14 (2021). Some state and federal regulators have begun creating special-purpose, nonbank-bank-type, charters to accommodate fintech and cryptocurrency companies. *See*, *e.g.*, 021-0002-20 WYO. CODE R. § 1 et seq. (LexisNexis 2022) (establishing standards for a "Special Purpose Depository Institution" charter); *see also* OFF. OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S LICENSING MANUAL SUPPLEMENT: CONSIDERING CHARTER APPLICATIONS FROM FINANCIAL TECHNOLOGY COMPANIES (July 2018), https://perma.cc/467X-5KKK (establishing standards for a "special purpose depository institution" charter).

344 Some of the privileges of banking, like deposit taking, have been extended to nonbank-banks, albeit on a limited basis. *See* Edge Act, s*upra* note 48, at 379–80.

EACs' ability to engage in digital asset activities depends upon whether they are "usual in connection with the transaction of the business of banking or other financial operations abroad."[345] An EAC may also engage in domestic financial activities that are "incidental to their international or foreign business[,]"[346] including an activity that has a "direct or clearly identifiable connection to international transactions."[347] Some digital assets have been held out as a potential medium for cross-border payments and financial transactions.[348] EACs already engage in financial activities that are at least analogous, if not directly applicable, to cryptocurrency transactions.[349] For example, some GSIBs use their EACs for custody services, an important function for "safeguarding" digital assets and incorporating them into the banking system.[350]

Recently proposed legislation would resolve this interpretive issue directly by including EACs in the list of financial firms that would receive explicit statutory authorization to issue digital assets.[351] A better proposal is included in a recent report by the

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345 12 C.F.R. § 211.10(c).

346 12 C.F.R. § 211.6(b).

347 Order Issued under Section 25 of the Federal Reserve Act: Citibank International, 71 FED. RES. BULL. 265, 266 (1985).

348 *See*, *e.g.*, FIN. STABILITY BD., ENHANCING CROSS-BORDER PAYMENTS: STAGE 3 ROADMAP 5 (Oct. 13, 2020), https://perma.cc/TU8C-7JBZ ("Recent advances in technology and innovation have created the potential for new payment infrastructures and arrangements for cross-border payments. These could offer solutions to challenges that are not easy to address through adjustments to existing processes.").

349 *See* 12 C.F.R. § 211.10(a)(13)–(15), (18)–(19) (permitting EACs to offer a variety of debt, equity, swaps and futures products). BHCs wishing to engage with digital assets may require a complementary order from the Fed pursuant to section 4(k) of the BHCA. *See* DOUGLAS LANDY & JAMES KONG, WHITE & CASE, COMPLEMENTARY: BITCOIN TRADING REQUIRES COMPLEMENTARY TO A FINANCIAL ACTIVITY AUTHORITY UNDER THE BANK HOLDING COMPANY ACT (May 24, 2021), https://perma.cc/RS3G-FZH9. Banking regulators often permit regulated institutions to engage in activities that are analogous to activities that they are already permitted to engage in. *See*, *e.g.*, Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed The "Business of Banking"*, 63 U. MIAMI L. REV. 1041, 1060 (2009).

350 The GSIB State Street uses its EAC, State Street International Holdings to "support global custody and associated critical operations" through a number of international subsidiaries. STATE STREET CORP., 2019 RESOLUTION PLAN PUBLIC SECTION 51 (2019), https://perma.cc/SF4Y-V9M4. *See also* JONATHAN V. GOULD, OCC INTERPRETIVE LETTER NO. 1170 (July 22, 2020), https://perma.cc/X2D4-PL2M ("Providing custody services for cryptocurrency . . . is a permissible form of a traditional banking activity that national banks are authorized to perform . . . .").

351 *See* Lummis-Gillibrand Responsible Financial Innovation Act, S. 4356, 117th Cong. § 101 (as introduced by Senate, June 7, 2022). The proposed legislation would include in the definition of "person who provides digital asset services" any "financial institution," as defined by the Commodity Exchange Act, a term that includes EACs. *See* 7 U.S.C. § 1a(21)(B).

President's Working Group on Financial Markets in collaboration with two bank regulatory agencies, which recommends that Congress enact legislation limiting the issuance of "stablecoin" cryptocurrencies to insured depository institutions.[352] This would both exclude EACs from such activities and would subject stablecoin issuers, and potentially digital custodians, to banking laws and their parent companies to the BHCA. Unless this bank-like activity is limited to federally insured banks, EACs provide a potential avenue for regulatory arbitrage by BHCs and other companies interested in participating in digital asset activities.[353]

Limited regulation of EACs' digital asset activities leaves them exposed to risks that harken back to the infamous international banking episodes described above. First, because most individuals and businesses do not solely transact in cryptocurrency, it must eventually be converted into fiat currency, implicating risks similar to Hertsatt risk.[354] Second, the challenges of overseeing organizationally complex international and offshore crypto exchanges have echoes in the BCCI failure. Finally, digital assets raise money-laundering and compliance risks that echo Riggs bank and other cases.[355] Each of these episodes resulted in changes to risk management oversight, including the passage of laws such as ILSA and FBSEA.

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352 *See* PRESIDENT'S WORKING GRP. ON FIN. MKTS., FED. DEPOSIT INS. CORP. & OFC. OF THE COMPTROLLER OF THE CURRENCY, REPORT ON STABLECOINS 16–17 (Nov. 2021), https://perma.cc/7W7Q-RF4F [hereinafter PRESIDENT'S WORKING GRP. REPORT].

353 CLS demonstrates the ability of the Fed to regulate holding companies as BHCs, even where they do not technically own "banks," a potentially useful precedent for regulating the companies that own special-purpose crypto banks. The President's Working Group report raises the possibility that stablecoin issuers could be regulated as payment, clearing, and settlement systems, or financial market utilities (FMUs), as is the case for CLS. *See* PRESIDENT'S WORKING GRP. REPORT, *supra* note 352, at 18.

The public-private partnership model of CLS offers another analogy to cryptocurrency. Just as the crypto project seeks to replace publicly issued money with private money, the creation of CLS was a private solution to a problem that might have been solved by the public sector. *See* Christine M. Cumming, First Vice President, Fed. Rsrv. Bank of N.Y., Remarks at the Celebration of the 10th Anniversary of CLS (Apr. 17, 2013), https://perma.cc/V7HA-HBGL (referring to the creation of CLS as "a great model of public-private cooperation made possible by private-sector leadership" that "exemplifies the productivity of public sector-private sector collaboration").

354 *See* Steve H. Hanke & Matt Sekerke, *Time to Stop Coddling Crypto*, WALL ST. J. (May 25, 2022), https://perma.cc/NDU5-Z9MP.

355 Miami has become a hub of digital asset activity in the U.S., echoing its past role as a destination for money laundering activity. *See supra* Part I.C.3; *see also* Andrew Singer, *Miami Stakes the Claim to Become the World's Bitcoin and Crypto Capital*, COINTELEGRAPH (June 11, 2021), https://perma.cc/NTJ5-PFRF.

2. Capital Standards

EACs have long enjoyed a special dispensation under bank capital rules. Under Regulation K, EACs must act in accordance with high standards of banking or financial prudence and maintain capital levels commensurate with the scope and nature of their activities.[356] As with other aspects of the Edge Act, fidelity to these principles has waned over time.

Reflecting a broader debate about the alleged tradeoffs between solvency requirements and competition,[357] EACs have benefitted from successively weakening capital requirements. Prior to the IBA, EACs were restricted from leveraging their capital more than ten times.[358] A view emerged that EACs were being "subject to restrictions that some consider to place them at a disadvantage relative to their foreign competitors."[359] The IBA sought to eliminate the "apparent disadvantages" imposed by EACs' leverage ratio, which its opponents argued was unduly "discriminatory" because no other foreign or domestic institutions were subject to such a limitation.[360] As a result of this advocacy, EACs were freed to leverage themselves up to fifteen times.[361]

Today, banking EACs are subject to a 10% total capital-to-risk-weighted-assets ratio, and 5% ratio of tier 1 capital-to-risk-weighted-assets,[362] lower standards than those applicable to traditional banking entities. As noted above, following the GFC, the Basel III International Capital Accord raised capital standards and established a level of consistency across legal jurisdictions.[363] These rules impose a 10% capital-to-risk-weighted assets ratio and an 8% tier 1 capital-to-risk-weighted assets ratio for banking organizations to be considered "well capitalized."[364] As also noted

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356 *See supra* notes 254–55 and accompanying text.

357 *See supra* notes 292–97 and accompanying text.

358 John P. Segala, *A Summary of the International Banking Act of 1978*, 69 FED. RSRV. BANK OF RICHMOND ECON. REV. 16, 20 (1979).

359 *Id.*

360 *Id.*; *see also* Floorman, *supra* note 132, at 62. By contrast, other major U.S. banks were leveraged up to 25 or 30 times. *See* Bennett, *supra* note 173.

361 *See* Bennett, *supra* note 173. The Fed also implemented a requirement for EACs to maintain a minimum ratio of 7 percent of capital and surplus to risk assets. *See supra* note 250; *see also* Floorman, *supra* note 132, at 63.

362 *See* 12 C.F.R. § 211.12(c)(2). The previous requirement had been a minimum ratio of 7% of capital and surplus to risk assets. *See* Int'l Banking Operations, 44 Fed. Reg. 36005, 36007 (June 20, 1979), codified at 12 C.F.R. § 11.

363 *See supra* notes 290–91 and accompanying text.

364 *See* Regulatory Capital Rules, 78 Fed. Reg. 62018, 62042 (Oct. 11, 2013), codified at 12 C.F.R §§ 208, 217, 225. Entities subject to the Basel rule must also meet minimum ratios for core shareholder equity-to-risk-weighted assets, as well as leverage ratios that limit borrowing relative to total un-risk-adjusted assets. *See id.*

above, the U.S.-implemented regulations contained no specific provisions for EACs.[365]

In addition, while banks and BHCs are required to deduct any investments in "financial subsidiaries" from the calculation of assets and capital,[366] a bank or BHC is not required to deduct its investment in EACs for regulatory capital purposes.[367] EACs may also participate in investments that would otherwise be subject to deduction were they to be carried out pursuant to the provisions of GLBA, rather than the Edge Act.[368]

This discussion illustrates that EACs are held to lower capital requirements than their parent banks, as well as comparable subsidiaries. This favorable capital treatment makes EACs attractive vehicles for certain investments and activities insofar as they produce more generous returns on invested capital, all else equal. Certain EAC investments and activities may therefore be undercapitalized relative to their risk profiles and might at some point require support from their U.S.-based parent companies.[369]

3. Affiliate Transactions

EACs are excluded from the rules limiting transactions between banks and their affiliates.[370] Section 23A of the FRA was enacted in 1933 to further Glass-Steagall's policies of protecting the insured banking system from excessive risk and preventing the federal "safety net" from supporting risky activities beyond

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365 Some have argued that, in enacting the capital provisions of the IBA, Congress believed that "parent banks should be sufficient and that separate capital requirements for each Edge Corporation are not necessary." Floorman, *supra* note 132, at 62.

366 *See* 78 Fed. Reg. at 62057; *see also* 12 C.F.R. §§ 3.22(a)(7), 217.22(a)(7).

367 *See* 12 C.F.R. § 225, Appx. A, II.B.2 (applicable to unconsolidated subsidiaries and functionally regulated subsidiaries). However, the Fed has reserved the right to deduct investments in subsidiaries and joint ventures on a case-by-case basis. *See id.*

368 For example, BHCs have traditionally used EACs to make private equity-type merchant banking investments. *See* Alan Greenspan, Chairman, Bd. of Governors of the Fed. Rsrv. Sys., Banking Evolution, Remarks at the 36th Annual Conference on Bank Structure and Competition (May 4, 2000), https://perma.cc/H3SB-4FTS. Merchant banking investments are deductible from a BHC's capital if conducted by a functionally regulated broker-dealer subsidiary of a BHC or a financial subsidiary of a bank. *See* 12 C.F.R. § 225, Appx. A, II.B.5 (requiring deduction of merchant banking investments held under section 4(k) of the BHCA). EACs, by contrast, are not subject to such limitations.

369 *See infra* section III.A.3.

370 While the London Whale was one example, other international banking organizations also generally run their derivatives businesses out of foreign legal entities because such activities are more lightly regulated in other countries. *See, e.g.*, Charles Levinson, *U.S. Banks Moved Billions of Dollars in Trades Beyond Washington's Reach*, REUTERS (August 21, 2015), https://perma.cc/QS28-3A4U.

the business of banking.[371] Section 23A sets quantitative limits on transactions between banks and nonbank affiliates within the BHC structure, subject to exemptions granted by the Fed. CEBA added section 23B to the FRA, requiring a range of transactions between FDIC-insured banks and their affiliates to be conducted on terms and conditions that are at least as favorable to the banks as those for comparable transactions involving nonaffiliated companies.[372] Sections 23A and 23B are often held out as a means of checking the "[a]buses in the dealings between banks and the companies in which banks or their BHCs have investments."[373]

With the transformation of banks into modern financial conglomerates, section 23A became an important prophylactic between regulated banking and speculative activities being conducted under the same corporate structure.[374] The terms of 23A and 23B historically exempted banks' operating subsidiaries, including EACs.[375] Financial subsidiaries authorized by GLBA, which the Fed has included by regulation, are the exception to this rule.[376] EACs are exempt from GLBA's definition of "financial subsidiary."[377] As a result, transactions between banks and their EAC subsidiaries are not subject to the quantitative limits and arms-length requirements of sections 23A and 23B.[378] After the

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371 *See* Saule T. Omarova, *From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act*, 89 N.C. L. REV. 1683, 1729–50 (2011).

372 *See* Pub. L. No. 100-86, § 102, 101 Stat. 552, 554 (1987).

373 Gruson, *supra* note 64, at 504.

374 *See* Omarova, *supra* note 371, at 1687. The Fed cited GLBA's passage as a justification for issuing, for the first time, a comprehensive rule, Regulation W, interpreting section 23A, in 2001—69 years after the provision was first enacted. *See* Transactions Between Member Banks and Their Affiliates (Regulation W), 12 C.F.R. § 223; *see also* 67 Fed. Reg. 76560, 76560-61 (Dec. 12, 2002).

375 *See* 12 U.S.C. § 371c(b)(2)(A); *see also* Bd. of Governors of the Fed. Rsrv. Sys., Applicability of Sections 23A and 23B of the Federal Reserve Act to Transactions Between a Member Bank and Its Subsidiaries, 62 Fed. Reg. 37744, 37746 (July 15, 1997) ("The second group of subsidiaries exempt under the 1933 Act were Edge Act subsidiaries and Agreement corporations. Because those companies were almost always subsidiaries of a bank, Congress did not retain a specific exception for them after the 1982 amendments (because they, like all other subsidiaries, were already exempt).").

376 *See* Transactions Between Member Banks and Their Affiliates, 67 Fed. Reg. at 76562.

377 *See* 12 U.S.C. § 24a(g)(3)(b).

378 *See* 67 Fed. Reg. at 76562–63; *see also* Margin and Capital Requirements for Covered Swap Entities, 79 Fed. Reg. 57348, 57359 (Sept. 24, 2014), codified at 12 C.F.R. pt. 45 ("While section 23B applies to transactions between a bank and its financial subsidiary, it does not apply to transactions between a bank and other subsidiaries, such as an operating subsidiary, an Edge Act subsidiary, or an agreement corporation subsidiary."); *see also* 12 C.F.R. § 225.121(b) (noting, in determining that it is permissible for a commercial bank to acquire the EAC subsidiary of its BHC, that "[b]y its specific terms, the provisions of section 23A do not apply to an affiliate organized under" the Edge Act). Note, however,

GFC, when risky overseas derivatives trades threatened the solvency of U.S. affiliates, the Dodd-Frank Act extended 23A to securities lending and derivatives.[379] Because section 23A and 23B are inapplicable to EACs, however, derivatives exposures can be transferred from banks to EACs on less onerous terms than those applicable to other affiliates.[380]

To illustrate this point, the London Whale's derivatives—booked in Whitefriars U.K., a subsidiary of an EAC that is exempt from 23A and 23B—could be transferred to JPMorgan's national bank branch without being subject to prudential protections like posting margin on arms-length terms, which would ordinarily apply to such trades.[381] In addition, banks' credit concentration

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that EACs that are subsidiaries of a BHC may be subject to sections 23A and 23B as affiliates of banks. At the same time, it might be possible for a nonbank affiliate to circumvent these restrictions by entering into an interaffiliate swap transaction with an EAC that then enters into a back-to-back transaction with its bank parent. In the absence of broader interaffiliate protections, Regulation K imposes some 23B-like requirements on Foreign Banking Organization (FBO)-owned EACs, but not U.S. BHC-owned EACs. *See* 12 C.F.R. § 211.5(d)(2)(ii).

[379] *See* Pub. L. No. 111-203, § 608(a), 124 Stat. 1376, 1608 (2010). The Fed's 2002 Regulation W final rule stated that the Fed at that time expected to invite public comment on whether to subject certain derivatives to section 23A, but it never proposed such a rule. *See* Transactions Between Member Banks and Their Affiliates, 67 Fed. Reg. at 76588–89; S. REP. NO. 111-176, at 86 (2d. Sess. 2010). According to the Dodd-Frank Senate committee report, Congress included derivatives exposures as covered transactions under 23A in that law because "[i]nter-affiliate derivative transactions are a major source of intra-firm complexity among the largest depository institutions[,]" and the lack of proper limits "created a perverse incentive for banks to engage with their affiliates in these more complex, volatile and opaque transaction forms." S. REP. NO. 111–176, at 86. Limiting derivatives transactions would "result in greater transparency and disclosure of derivative transactions between banks and their affiliates, a reduction in the volume of internal risk-shifting transactions, and in the simplification of the internal structures of our major financial firms." *Id.* at 86–87.

[380] *See* Duffie, *supra* note 324. Sections 23A and 23B are not the only regulations that can be circumvented using this legal structure. Originating derivatives from an EAC and then engaging in back-to-back trades with a U.S. affiliate can also avoid triggering rules applicable to swaps trading and dealing, because the positions are booked extraterritorially and interaffiliate trades are not counted against the threshold for registering as a swap dealer with the Commodity Futures Trading Commission. *See* Commodity Futures Trading Comm'n, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 56924, 56947–49 (Sept. 14, 2020). The banking industry cited the Edge Act's purpose to "promote such entities' ability to compete in foreign jurisdictions" as a policy justification for exempting overseas trades. *See* Commodity Futures Trading Comm'n, Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45291, 45298 (July 26, 2013).

[381] Derivatives contracts and regulations require institutions to post assets, largely cash and other liquid assets, known as margin, to their counterparties to protect against their prospective credit exposure. Margin requirements restrict the portion of transactions that can be made using borrowed money, a method of limiting the amount of financial market leverage. *See* Samuel G. Hanson et al., *A Macroprudential Approach to Financial*

limits do not apply to EACs,[382] meaning that the exposures between banks and affiliated EACs can grow to be significant. In the event that an EAC experiences financial distress, it could fail to make full payments obligated by its unsecured derivatives. This is true even, or perhaps especially, for counterparties owned by the same parent company, which would make the parent institution responsible for settling the contract. [383] In that scenario, the U.S. parent, a taxpayer-insured bank, would likely be compelled to support its subsidiary through financial assistance or forbearance.[384] This would create *de facto* taxpayer support for the bank's affiliate, including through FDIC deposit insurance and guarantees and Fed emergency lending.[385]

While derivatives provide an example of the risks of EACs' exemptions from sections 23A and 23B, these concerns could apply to a range of activities, including those involving digital assets. This regime increases both the potential risks to the safety and soundness of banks and their parent BHCs, and the likelihood of a taxpayer bailout.[386] This is particularly true for GSIBs,

Regulation, 25 J. ECON. PERSPECT. 3, 15–16 (2011). Collecting margin reduces exposures between counterparties, especially in transactions with legal entities that are more lightly regulated or less well-capitalized. *See* S. REP. NO. 111-176, at 33 (2010) ("While large losses are to be expected in derivatives trading, if those positions are fully margined there will be no loss to counterparties and the overall financial system and none of the uncertainty about potential exposures that contributed to the panic in 2008."). In 2015, the Fed imposed minimum margin requirements on interaffiliate trades between banks and EACs, however it revised the rule to reduce these requirements in 2020. Margin and Capital Requirements for Covered Swap Entities, 79 Fed. Reg. at 57359; Margin and Capital Requirements for Covered Swap Entities, 85 Fed. Reg. 39754 (July 1, 2020).

382 *See supra* note 240 and accompanying text. Calculating the credit exposure of a derivative contract generally requires adding the current credit exposure of the contract to a projection known as the contract's "potential future exposure." *See* 12 C.F.R. § 217.34.

383 In addition to implicit support, the U.S. parent and affiliates may provide funding or guarantees for the positions of overseas affiliates. For example, the bankruptcy of Lehman Brothers' European and U.K. affiliates impacted its U.S. affiliates' ability to obtain funding and settle trades. *See* Fed. Deposit Ins. Corp., The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act, 5 FDIC Q., no. 2, 2011, at 31, 33. Lehman's holding company also guaranteed derivatives contracts for its subsidiaries and affiliates, which it then defaulted on upon filing for bankruptcy. *See id.*

384 This was generally the case for BHCs during the 2008 financial crisis. *See, e.g.*, Omarova, *supra* note 214. The Fed has noted that there is precedent for EACs providing financial support to troubled foreign joint ventures in which they have invested equity. *See* 1976 FED. RES. BULL. 249 (Feb. 23, 1976).

385 EACs may be eligible to receive FDIC assistance or debt guarantees, pursuant to a systemic risk determination, indirectly through their parent banks, as well as emergency loans from the Fed through programs with "broad-based eligibility" during "unusual and exigent circumstances." *See* 12 U.S.C. § 1823(c); *see also* 12 U.S.C. § 5612; *also* 12 U.S.C. § 343.

386 As described above, EACs are more lightly capitalized than banks. *See supra* section III.A.2.

which are the most active in derivatives trading and have the largest international footprints.[387]

4. Legal Separations

Today, the scope of permissible bank activities under the Edge Act is largely a settled matter. This was not always the case. In the 1970s, Congressman Wright Patman argued that the Fed's interpretation that the Edge Act permits U.S. banks to engage in securities activities abroad that are prohibited domestically by the Glass-Steagall Act was a "false assumption."[388] To Patman, Glass-Steagall forbade U.S. banks from maintaining securities affiliates anywhere in the world, so allowing them to engage in investment banking overseas was a "violation of the spirit, if not the letter" of the law.[389] Instead, the Fed neither limited U.S. banks to activities that are permitted domestically, nor allowed U.S. banks to operate unfettered. The Fed pursued a middle path, known as "domestic plus,"[390] permitting U.S. banks to engage in activities that were authorized domestically, along with certain activities it deemed integral to overseas banking.[391]

This debate was largely mooted by GLBA, but it would return to relevance should the separation between deposit banking and other financial activities be reinstated.[392] Because a literal re-imposition of the original terms of Glass-Steagall would not close the overseas loophole,[393] BHCs could use the Edge Act to circumvent

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[387] *See* Houpt, *supra* note 206, at 609.

[388] JOINT ECON. COMM., *supra* note 37, at 100.

[389] *Id.* at 111. He was particularly irked by the successor institutions to the J.P. Morgan banking dynasty's use of the Edge Act to circumvent Glass-Steagall. *See id.* at 195. Ironically, the Edge Act's architects had framed the law as a means to challenge J.P. Morgan's dominance, *see supra* note 37, and yet the House of Morgan used the Edge Act to expand its global footprint. By 1962, the bank had equity investments in eleven foreign banks operating in countries including Peru, France, Morocco, and Australia. *See* CHERNOW, *supra* note 26, at 541–42.

[390] *See* INTERVIEW WITH MICHAEL G. MARTINSON, *supra* note 153, at 14.

[391] *See id.* Prior to the GLBA, the Fed rejected proposed joint ventures by Bank of America and Citibank to underwrite property and casualty insurance in Europe and Brazil, respectively. *See id.*, at 13-14. Eventually, it allowed banks to deal domestically in prohibited securities on the rationale that they had acquired sufficient expertise to conduct such activities in a safe and sound manner based on their experiences overseas. *See* Securities Industry Ass'n v. Bd. of Governors of the Fed. Rsrv. Sys., 900 F.2d 360, 365–66 (D.C. Cir. 1990).

[392] *See* WILMARTH, *supra* note 26, at 335–56.

[393] Recent Congressional proposals to enact a modern Glass-Steagall do not address section 25A of the FRA or EACs. *See* The 21st Century Glass-Steagall Act of 2017, S. 881, 115th Cong. (2017). By contrast, a proposal by former FDIC Vice Chairman Thomas Hoenig to strengthen firewalls and activity restrictions is more comprehensive, applying to BHCs with EAC subsidiaries. *See* Thomas M. Hoenig, Vice Chairman, Fed. Deposit Ins.

these firewalls in two ways. First, BHCs could continue to conduct a wide range of nonbank financial activities globally while booking them in EAC subsidiaries located overseas, just as the London Whale used JPMorgan's CIO.[394] BHCs' EAC subsidiaries could also engage in a certain amount of domestic activity to the extent that it is "incidental" to international business—a condition that is increasingly flexible with growing globalization, financialization, and digitization.[395]

The Edge Act is also an exception to the foundational policy separating banking from commerce.[396] The separation of banking and commerce is meant to prevent conflicts of interest and the diversion of credit to affiliated parties on anticompetitive terms.[397] The principle protects against the advantages afforded by banks' proximity to the government, via specially granted charters.[398] Consistent with the Edge Act's many tensions, the law's approach to banking and commerce contains contradictions.[399] As discussed above, any undermining of this policy raises significant concerns for both traditional financial activities as well as digitized financial services.

Corp., Remarks at the Institute of International Bankers Annual Washington Conference: A Market-Based Proposal for Regulatory Relief and Accountability (Mar. 13, 2017), https://perma.cc/E3KG-FFRX.

394 *See supra* note 381 and accompanying text. EACs would still be permitted to engage in at least 19 activities permitted by Regulation K, but would be limited in engaging in the "closely related" activities authorized by Regulation Y.

395 For example, a BHC could use an EAC to engage in joint ventures and other private equity-type investments in order to arbitrage any repeal of the permissions for merchant banking, commodities trading, and complementary nonfinancial activities currently in section 4(k) of the BHCA. *See* 12 U.S.C. § 1843(k)(4)(H).

396 *See* Bernard Shull, *The Separation of Banking and Commerce: Origin, Development, and Implications for Antitrust*, 28 ANTITRUST BULL. 255, 265–70 (1983). How strictly the U.S. has adhered to this policy has been vigorously debated. *See* Wilmarth, *supra* note 11. Yet, the separation of banking and commerce maintained symbolic relevance even during the era of deregulation. As Congress passed GLBA, weakening the line between banking and commerce by authorizing merchant banking investments in commercial businesses, it argued (inaccurately) that it was respecting the separation. *See* S. REP. NO. 106-44, at 9, 21 (1999).

397 *See* S. REP. NO. 100-19, at 8, (1987) ("The separation of banking from commerce helps ensure that banks allocate credit impartially, and without conflicts of interest. . . . A bank should always deal at arm's length with its customers—both in the interest of fairness to prospective borrowers and in the interest of maximizing economic growth."); *see also* S. REP. NO. 106-44, at 71 ("A bank that is affiliated with a commercial firm could have an incentive to make loans to that firm, even if the firm is less credit-worthy than other borrowers. The bank could have a similar incentive not to lend to the firm's competitors, even if they are credit-worthy.").

398 *See* Shull, *supra* note 396, at 274.

399 For example, it prohibits direct commodity trading and ownership, and originally contained protections against interlocking ownership, while providing EACs general authority to own nonfinancial businesses. *See supra* notes 45–49.

5. Cross-Border Resolution

Financial risks become most salient when financial institutions approach the point of insolvency. Historical examples of prominent international banking failures, including Bankhaus Herstatt, BCCI, Barings, LTCM, and Lehman Brothers, help to underscore the challenge of resolving a global financial conglomerate.[400] Three particular factors complicate cross-border resolution: (1) separate but interconnected legal structures; (2) use of derivatives and other financial contracts; and (3) reliance on runnable funding sources.[401] EACs possess all of these attributes, and would thus pose challenges under Dodd-Frank's OLA process for resolving an internationally active BHC.

The FDIC has adopted a "single point of entry" (SPOE) approach to carry out OLA.[402] Under SPOE, the FDIC seizes control of a BHC, forms a bridge financial company, imposes losses upon equity holders, and converts some bondholders into equity in a new legal entity that emerges from receivership, with remaining claims transferred to the successor company.[403] This is similar to the FDIC's receivership process for failing banks.[404]

EAC resolution is less straightforward, demonstrating how organizational complexity can impede the orderly liquidation process. The Fed has authority to appoint a receiver or conservator for a failing EAC.[405] In some cases, the FDIC may be able to appoint itself receiver of an EAC as part of an OLA process, following a joint determination by the FDIC and the Treasury Secretary that the appointment "would avoid or mitigate serious adverse effects on the financial stability or economic conditions of the

400 *See* Richard Herring, *The Challenge of Resolving Cross-Border Financial Institutions*, 31 YALE J. ON REG. 853, 863–72 (2014).

401 *See* GOVT. ACCOUNTABILITY OFF., *supra* note 222, at 28–35.

402 *See* Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy, 78 Fed. Reg. 76614 (Dec. 18, 2013).

403 In order to facilitate the SPOE process, the Fed has issued a Total Loss Absorbing Capacity (TLAC) rule to require the largest financial institutions to maintain minimum amounts of capital and long-term, unsecured debt at the holding company level that would be converted into capital in a new bridge holding company and used to recapitalize its subsidiaries. 12 C.F.R. § 252.160–67. *See also* Bd. of Governors of the Fed Rsrv. Sys., Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations, 82 Fed. Reg. 8266 (Jan. 24, 2017).

404 *See* 12 U.S.C. § 1821. An important distinction between the two processes is the fact that OLA utilizes TLAC and a line of credit from the Treasury to ensure funding and liquidity, whereas the FDIC utilizes its deposit insurance fund to fund bank depositors.

405 *See* 12 U.S.C. § 624. The Fed may require the receiver or conservator to file for a Chapter 11 bankruptcy. *See id.*

[U.S.]."[406] The need for coordination between home and host country authorities further complicates the resolution process.[407] National authorities have a predilection to "ringfence" domestic assets, preserving resources located in certain jurisdictions to pay creditors within the same jurisdiction.[408] Regulators have acknowledged that complex international banking conglomerates pose a significant challenge to orderly resolution, increasing the difficulty of identifying and resolving financial claims.[409] Indeed, the resolution of BCCI's U.S. subsidiary was only possible because it had been largely separated as a legal entity.[410] Conversely, "interaffiliated operational, credit, or reputational relationships,"[411] as exist between EACs and their affiliates and parents, substantially complicate resolution.

The opacity and volatility of derivatives, sometimes known as qualified financial contracts (QFCs), is another potential difficulty for the resolution process.[412] Notwithstanding post-GFC

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[406] 12 U.S.C. § 5390(a)(1)(E). The provision applies to any subsidiary that is a corporation "organized under Federal law or the laws of any State." Many of the EAC subsidiaries of the largest BHCs are organized as New York or Delaware corporations. However, only EAC subsidiaries of BHCs would be eligible for this authority, but not EAC subsidiaries of banks. *See* 12 U.S.C. § 5381(a)(9)(A).

[407] *See* Allahrakha et al., *supra* note 278, at 3; *see also* Fed. Deposit Ins. Corp., *supra* note 383, at 45 ("[In a hypothetical cross-border resolution, the FDIC] would have continued a dialogue with key foreign financial authorities to discuss what legal or financial issues might arise out of an FDIC receivership, or out of foreign resolution regimes in the case of . . . entities operating outside of the United States, and how those resolutions could be coordinated."). Dodd-Frank requires the FDIC to coordinate "to the maximum extent possible" with its counterparts in the orderly liquidation process. 12 U.S.C. § 5390(a)(1)(N). This language is more symbolic and aspirational, however, than practically enforceable.

[408] *See* Baxter and Freis, *supra* note 34, at 69–70.

[409] *See* Charles Taylor, Deputy Comptroller for Capital and Regulatory Policy, Ofc. of the Comptroller of the Currency, Remarks at the Inst. of Int'l Bankers Annual Washington Conference 5–6 (Mar. 3, 2014), https://perma.cc/P99U-VG5M.

[410] *See* CHAIRPERSON OF THE FIN. STABILITY OVERSIGHT COUNCIL, STUDY OF THE EFFECTS OF SIZE AND COMPLEXITY OF FINANCIAL INSTITUTIONS ON CAPITAL MARKET EFFICIENCY AND ECONOMIC GROWTH PURSUANT TO SECTION 123 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT OF 2010 20–21 (Jan. 2011), https://perma.cc/K9CN-QB4M.

[411] *Id.* at 21.

[412] According to the FDIC:

> A complex, systemic financial company can hold very large positions in qualified financial contracts, often involving numerous counterparties and back-to-back trades, some of which may be opaque and incompletely documented. A disorderly unwinding of such contracts triggered by an event of insolvency, as each counterparty races to unwind and cover unhedged positions, can cause a tremendous loss of value, especially if lightly traded collateral covering a trade is sold into an artificially depressed, unstable market. Such disorderly unwinding can have

measures implemented to mitigate potential contagion, some uncertainty remains regarding the treatment of QFCs in various insolvency processes.[413] Derivatives are prioritized in the U.S. bankruptcy code, allowing counterparties to liquidate their collateral outside of the temporary stay requiring court approval ordinarily applicable to secured loans.[414] OLA likewise exempts QFCs from otherwise applicable stay provisions,[415] entitling derivatives counterparties to accelerate or terminate their contracts beginning 24 hours after a receiver is appointed.[416]

In the event of counterparty insolvency, it is viewed as the "normal business practice" for a party to accelerate its QFC rights and offset potential losses by taking possession of collateral.[417] In short, creditors under a QFC can start a run on their vulnerable counterparties. The FDIC is left to make a quick determination about whether to transfer or repudiate either all or none of a company's QFCs—it cannot choose to selectively transfer or repudiate certain contracts.[418] Repudiating these contracts could lead to financial contagion and spillovers, while assuming these contracts could eventually require public support in the form of liquidity or guarantees, in order to make counterparties whole. The OLA process is thus likely to be complicated by the use of EACs as derivatives booking entities.

> severe negative consequences for the financial company, its creditors, its counterparties, and the financial stability of the United States.

Fed. Deposit Ins. Corp., *supra* note 383, at 38.

413 *See* OFF. OF FIN. RESEARCH, 2017 FIN. STABILITY REP. 18 (2017), https://perma.cc/TBY3-MU7T. Most of the GSIBs hold derivatives in their bank subsidiaries, however, some hold them in nonbank subsidiaries. *See id.* at 17. While the applicable processes may differ, there is a degree of consistency in the treatment of QFCs across the respective resolution regimes.

414 *See* 11 U.S.C. §§ 101(53B), 560. For a brief history of this provision see Kenneth Kettering, *Securitization and its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1648 (2008); *see also id.*, at 1651–52.

415 *See* 12 U.S.C. § 5390(c)(8). Derivatives counterparties are also exempted from any stay occurring in the FDIC's bank conservatorship or receivership process. *See* 12 U.S.C. § 1821(e)(8). In 2017, regulators finalized a rule requiring U.S. GSIBs to amend their QFCs to include provisions incorporating the stay exceptions. *See* Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions, 82 Fed. Reg. 42882 (Sept. 12, 2017), codified at 12 C.F.R. §§ 217, 249, 252.

416 *See* 12 U.S.C. § 5390(c)(10)(A)–(B). This is also true in a traditional bank receivership. *See* 12 U.S.C. § 1821(e)(10)(B). The derivatives stay provisions have also been extended to EACs that operate, or operate as, clearing organizations, in the same way that they apply to banks. *See* 12 U.S.C. § 4406a.

417 H. REP. NO. 108-277, at 20 (2003).

418 *See* 12 U.S.C. § 5390(c)(9), (11). Again, the same is true in a bank receivership. *See* 12 U.S.C. § 1821(e)(9)-(10).

Finally, although EACs are permitted to hold certain deposits and deposit substitutes, including offshore dollar-denominated instruments, they are not required to register for federal deposit insurance. Uninsured deposits are known to be prone to funding runs.[419] This raises safety and soundness concerns, including the possibility of parent company financial support and the allocation of losses across legal entities and jurisdictions. The role of uninsured deposits in panics, bank runs, and failures was the key motivation that led Congress to establish a federal deposit insurance program during the banking panic of 1929. That significant portions of EACs' liabilities consist of uninsured deposits increases the likelihood of funding runs coinciding with the resolution process.

The confluence of inter-jurisdictional coordination, derivatives concentration, and runnable funding make EACs a unique obstacle to the orderly resolution of a GSIB. Within this context, consider the example of Citigroup. As the public portion of Citi's resolution plan demonstrates, Citi's parent companies and foreign subsidiaries are connected by an extensive, complex, and generally opaque web of capital supports, borrowing, and other financial exposures.[420] Nonetheless, the public portion of Citigroup's resolution plan does not identify COIC, its EAC, as a material entity.[421] Rather than addressing the challenges of an EAC-related resolution, and establishing a plan for such a scenario, Citi's resolution plan assumes that its foreign legal entities would be capitalized and supported, obviating the need for simultaneous resolutions by foreign supervisory agencies.[422]

In the absence of a clearly articulated plan, it is likely that EACs could pose significant challenges to a GSIB's orderly resolution. Given the lack of structural separations between EACs, their parent banks, and the broader BHC structure, as well as the nature of the activities and funding sources relied upon by EACs,

419 *See* Resolution Plans Required for Insured Depository Institutions With $50 Billion or More in Total Assets, 84 Fed. Reg. 16620, 16622 (Apr. 22, 2019), codified at 12 C.F.R. § 360 ("Uninsured deposits and market funding are more likely to be withdrawn rapidly should an IDI exhibit signs of financial distress.").

420 *See* CITIGROUP RESOLUTION PLAN, *supra* note 309, at 40–59.

421 GSIBs' resolution plans "define their core business lines differently . . . making it difficult to use this metric to compare the organizational complexity of different companies." Bright et al., *supra* note 223, at 4. Citi's public portion of its resolution plan does describe, in general terms, the supervision of its national bank, including foreign branches and subsidiaries. *See* CITIGROUP RESOLUTION PLAN, *supra* note 309, at 104. While Citi operates in a hundred jurisdictions, it only lists two of those as material supervisory authorities. *See* Bright et al., *supra* note 223, at 6.

422 *See* CITIGROUP RESOLUTION PLAN, *supra* note 309, at 17.

the feasibility of an orderly cross-border resolution of an organizationally complex GSIB such as Citigroup remains to be seen.

While this has only been a brief discussion of the potential risks involved in international banking,[423] it is now worth considering reforms to the laws and regulations that apply to U.S. banks' international operations. Specifically, revising the antiquated Edge Act framework carries some potential for addressing the risks and vulnerabilities outlined by this Article.

B. Back from the Edge: Reforming the Edge Act

There are several options available to address the anachronistic Edge Act framework, but before delving into such proposals, it is important to note the broader need for policymakers to reconsider their roles and responsibilities. In recent decades, the Edge Act and its implementing regulations have focused on the "competitiveness" of U.S. banks, and not the financing of industrial or agricultural trade and exports. "Competition" has become coded terminology, essentially a euphemism for a race-to-the-bottom. The first step toward reform requires a shift away from these tropes, thereby creating an important cognitive opening for reforms to the Edge Act, and to U.S. banks' international activities more broadly.

1. Legislative Reform

The most direct method of mitigating the risks raised by the Edge Act would be legislative repeal, aimed to eliminate these nonbank-banks altogether. There is no justification, post-GLBA, for the range of EAC activities belonging inside a lightly regulated subsidiary of a bank, as opposed to a nonbank subsidiary of a BHC subject to a comprehensive suite of legal protections. Under the status quo, the Federal "safety net" is exposed to nonbanking financial intermediation activities that are exempted from the restrictions that apply to banks, including capital rules and limits on affiliate transactions.

The justifications for repealing these provisions are analogous to those advanced by the Fed in its proposal to repeal certain nonbanking activities permitted under section 4 of the BHCA, as

[423] For example, systemically important international banking conglomerates also present political economy concerns. *See* Norton, *supra* note 266, at 49–51; *see also* Adam William Chalmers, *When Banks Lobby: The Effects of Organizational Characteristics and Banking Regulations on International Bank Lobbying*, 19 BUS. & POL. 107 (2017) (finding that banking organizations with greater financial resources and international banking activity are more likely to lobby at the international level).

amended by GLBA. The Fed argued that doing so would "create a more level playing field" between large and small BHCs, as well as "help to enhance safety and soundness, minimize the concentration of economic resources by limiting an institution's ability to take on risk associated with commercial activities, and help ensure the separation of banking and commerce."[424] The Fed also recommended eliminating the provisions authorizing industrial loan companies (ILCs), another form of nonbank-bank, because ILCs undermine key principles of banking law, including the effectiveness of consolidated supervision, the separation of banking and commerce, and fair competition.[425] The Edge Act raises similar policy concerns to the provisions that the Fed has recommended repealing; therefore its repeal would be consistent with these policy goals.

Alternatively, Congress could amend the definition of "bank" as it is used throughout various statutes to ensure that it includes EACs, thereby extending the intent of CEBA to an additional category of nonbank-bank entity. Doing so would subject EACs to the regulations that apply to insured depository institutions. At the same time, Congress could clarify and strengthen the Fed's supervisory powers over banks with EAC subsidiaries by removing the BHCA requirement that requires deference to the primary regulator of functionally regulated subsidiaries.[426] This would provide greater supervisory clarity and situate responsibility for a single type of legal entity within a single agency.

While it is admittedly a difficult path, congressional action is the ideal vehicle for Edge Act reforms. Given the movement toward the digitization of financial services, the time is right for a renewed debate on the scope of permissible banking activities and the separation of banking and commerce, and with it a clearer delineation of the boundaries of these longstanding policies. The status quo permits, through the exceptions and preferences granted to EACs, unequal capital treatment and it allows a variety of otherwise impermissible activities to occur within the banking system. As a result, the U.S. is vulnerable to the risks of

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[424] BD. OF GOVERNORS OF THE FED. RESRV. SYS., FED. DEPOSIT INS. CORP. & OFC. OF THE COMPTROLLER OF THE CURRENCY, REPORT TO THE CONGRESS AND THE FINANCIAL STABILITY OVERSIGHT COUNCIL PURSUANT TO SECTION 620 OF THE DODD-FRANK ACT 28–31 (2016). For an in-depth discussion of the relevant provisions of section 4, see Omarova, *supra* note 214.

[425] *See* BD. OF GOVERNORS OF THE FED. RESRV. SYS., *supra* note 424, at 32–35. For a comprehensive discussion of the policy issues raised by ILCs, see Wilmarth, *supra* note 11.

[426] *See* 12 U.S.C. § 1844(c)(1)(B).

market dysfunctions, decreased competition, and a persistent too-big-to-fail problem with its accompanying taxpayer exposure.

2. Regulation and Enforcement

In the absence of congressional action, the Fed has options for updating the Edge Act framework through regulation. Again, there are similarities between the Edge Act and other recent efforts to update the regulation of BHC activities. In 2016, the Fed proposed an updated prudential framework for BHCs' physical commodity and merchant banking activities under section 4 and Regulation Y.[427] These proposed amendments were based upon the Fed's "supervisory experience" with BHCs' engagement in the relevant activities, as well as the "potential risks" associated with such activities.[428] Similar to GLBA, the Edge Act gives the Fed wide latitude to determine EACs' permissible activities in response to new developments, including the GFC, the "London Whale" episode, and the proliferation of digital assets.

Examples of potential regulatory reforms include stronger limits on EACs' permissible investments and EACs' transactions with affiliates. The "London Whale" enforcement action raises the question of whether some EACs have met, or continue to meet, the legal requirement that they be "well managed" in order to deal in equity securities abroad. Finally, both the "London Whale" and the experiences of Citigroup during the GFC call into question whether certain EACs adhere to the general principle of meeting "high standards of banking or financial prudence" required by Regulation K. As the Court of Appeals first ruled in 1929, in a case that remains on the books today, Congress granted "special and important privileges" to EACs and delegated significant discretion to the Fed to evaluate whether or not an institution possesses the "character and competency" to operate an EAC.[429]

There is also a broader question about whether the scope of activities permitted under the GLBA framework is consistent with the fact, reinforced by the IBA, that the Edge Act's "emphasis is on financing exports." The authorities governing EAC activities could be narrowed by revisiting the Fed's grant of "general consent" to EACs to engage in certain activities abroad without

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427 *See* Regulations Q and Y; Risk-Based Capital and Other Regulatory Requirements for Activities of Financial Holding Companies Related to Physical Commodities and Risk-Based Capital Requirements for Merchant Banking Investments, 81 Fed. Reg. 67220 (Sep. 30, 2016) (to be codified at 12 C.F.R. §§ 217, 225).

428 *Id.* at 67224.

429 *See supra* notes 72–74, and accompanying text.

affirmative approval, provided they satisfy certain criteria.[430] Reinvigorating the original purposes of the Edge Act would help to harmonize the scope of EACs' permissible activities with the original purposes of the Edge Act.[431]

Under the IBA, the Fed is required to review and update Regulation K once every five years, and yet it has barely been amended since the last post-GLBA revision in 2003, despite the myriad changes to the financial system since then. It should also be noted that, while agencies provide the least procedurally cumbersome path to reform, regulations are likely to be less holistic than legislation, and are certain to be less enduring. A particular administration, agency head, or majority of an agency's board may limit EAC charters or activities during the period that they have control, subject to the statutes as they are written. Their successors may then return to the status quo or push for an even more expansive approach. The resulting polices would be driven less by reasoned debate and intentional decision-making than by the personalities of the individuals or political parties that happen to be in control of the regulatory apparatus at any particular time.

V. CONCLUSION

This Article has explored the history and ongoing relevance of U.S. banks' international activities through the lens of the Edge Act. This case study offers an opportunity to evaluate the normative claim of financial policy doctrine that privatization and deregulation-driven "competitiveness" provides a boon to the nonfinancial economy through the financing of trade and exports. In a challenge to the financial policy consensus, the historical evidence demonstrates that the provision of private credit, facilitated through financial sector deregulation, is an ineffective means of expanding exports and the nonfinancial industries involved in producing them, such as manufacturing and agriculture.

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[430] Recent legislation has proposed repealing this general consent authority, however, this reform could be implemented through regulation, without an act of Congress. *See* Bank Merger Review Modernization Act of 2021, S. 2882, § 11(a)(1), 117th Cong. (2021).

[431] At a basic level, even more and better disclosure would help to enhance public understanding of U.S. banks' activities abroad. More comprehensive and granular information about the number of registered EACs, their identities, locations, total assets, and other data would provide observers with a better sense of their business models and potential risks.

In addition, consistent with the macro trends of globalization and financialization, the underlying goal of the policies governing U.S. banking abroad has shifted from using finance to support industrial trade, to promoting a robust financial sector as an end in itself. This particular deregulatory project imposes costs, in the form of exposure to added risks and complexity, outweighing its purported benefits. These are important lessons to be learned and applied as policymakers consider how to address the challenges posed by systemically important banks and nascent digital asset markets.