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Toward Transatlantic Convergence in Financial Regulation

Hwa-Jin Kim*

This Article reviews the historical background of the Glass-Steagall Act of 1933 along with the developments in the markets that led to the Gramm-Leach-Bliley Act of 1999. It analyzes the discussions on the Volcker Rule in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 from a comparative perspective. It shows how the reform in the United States may impact financial institutions and markets in other jurisdictions. Germany and Switzerland, where universal banking is the hallmark of the financial services industry, are the primary jurisdictions of interest. After taking a historical and political look at the regulation of financial institutions in the United States and Europe, this Article touches on the issues of global regulatory reform to see if the global solution might fit into the structural issues of financial institutions and systems. Building on the discussions on convergence in bank corporate governance, it predicts transatlantic convergence in the financial system and structure of banking business preceded by convergence in the practices and strategies of financial institutions in the United States and Europe.

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I. INTRODUCTION

The controversial Dodd-Frank Wall Street Reform and Consumer Protection Act[1] was signed into law on July 21, 2010. It will implement the sweeping financial reform that has been needed since the outbreak of the global financial crisis in 2007. One of the hottest issues discussed in the legislative

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank Act]. For summaries, *see* DAVIS POLK & WARDWELL LLP, SUMMARY OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (2010); SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP & AFFILIATES, THE DODD-FRANK ACT: COMMENTARY AND INSIGHTS (2010); and DEUTSCHE BANK, THE IMPLICATIONS OF LANDMARK U.S. REG. REFORM: THE DODD-FRANK WALL STREET REFORM & CONSUMER PROTECTION ACT (July 2010); Viral V. Acharya et al., *A Bird's-Eye View: The Dodd-Frank Wall Street Reform and Consumer Protection Act*, in: REGULATING WALL STREET: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE 1 (VIRAL V. ACHARYA ET AL. EDS., 2011).

process of the Dodd-Frank Act was the reinstatement of the Glass-Steagall Act of 1933, which separated investment banking from commercial banking. The reinstatement, however, did not happen; instead, the Dodd-Frank Act adopted the famous "Volcker-Rule,"[2] which addresses the issue, but does not introduce comprehensive new regulations on commercial banks' activities in capital markets. Under the soft constraints newly imposed by the Dodd-Frank Act, the framework established by the Gramm-Leach-Bliley Act of 1999 remains basically intact.[3]

The developments in the United States certainly impacts financial institutions and markets in other jurisdictions. The U.S. government may urge or encourage foreign governments to adopt the same rules if the short-term international competitiveness of the U.S. financial institutions may be harmed through the new regulation. There are provisions in the Dodd-Frank Act that can be seen as an attempt to force harmonization of international financial regulation. On the other hand, European countries also may take advantage of the regulatory reform in the United States as new momentum in their own reform efforts. Non-U.S. financial institutions may also voluntarily adapt to the new system when they go global, particularly through acquisitions.[4]

We now have various reports on the policy decisions of different countries. For instance, Nigeria recently decided to abolish the universal banking system as they felt that commercial banks' risk-taking activities might jeopardize the whole system.[5] Switzerland, on the contrary, saw no reason to change the

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[2] "I'm proposing a simple and common-sense reform, which we're calling the "Volcker Rule" -- after this tall guy behind me. Banks will no longer be allowed to own, invest, or sponsor hedge funds, private equity funds, or proprietary trading operations for their own profit, unrelated to serving their customers. If financial firms want to trade for profit, that's something they're free to do. Indeed, doing so – responsibly – is a good thing for the markets and the economy. But these firms should not be allowed to run these hedge funds and private equities funds while running a bank backed by the American people." Barack Obama, President of the U.S., Remarks by the President on Financial Reform (Jan. 21, 2010), *available at* http://www.whitehouse.gov/the-press-office/remarks-president-financial-reform.

[3] Yalman Onaran, *Volcker Said to Be Unhappy With New Version of Rule*, BLOOMBERG BUS. WK. (June 30, 2010), http://www.businessweek.com/news/2010-06-30/volcker-said-to-be-unhappy-with-new-version-of-rule.html.

[4] In the period between 1995 and 2008, 1,833 bank M&As were reported. Four hundred and sixty-six of them were cross-border deals. *See* George Andrew Karolyi & Alvaro G. Taboada, *The Influence of Government in Cross-Border Bank Mergers* 36 (Feb. 2011) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1573168 (also reporting that cross-border deals were larger in terms of the amount of deals).

[5] *Central Bank Ends Nigeria's Universal Banking System*, THE WILL, (Mar. 16, 2010), http://thewillnigeria.com/business/3926-Central-Bank-Ends-Nigerias-Universal-Banking-System.html.

traditional framework. They believed that the investment banking arms of the Swiss banks might neutralize the losses incurred by the housing loans.[6] Other countries will have their own reasons and political background to apply to their reform in the regulation of financial institutions and markets. The response made by foreign governments will in turn influence U.S.-banks' strategies in the global financial markets. Also, if states decide to keep the universal banking system in its traditional or modified form for strategic reasons, they will have to find alternative tools to make sure that their large financial institutions do not create excessive local, as well as global, systemic risk in the future.

This Article explores these questions while revisiting the universal banking system. As universal banking is the hallmark of the European financial services industry,[7] this paper puts the U.S. system in comparative perspective with the European system. It takes a historical and political look at the regulation of financial institutions in the United States and Europe. Historical and political differences in these states can provide us with answers to how these countries approach the restructuring of their own, as well as the global, financial services industry. This Article also shows that the financial services industry in the United States and Europe share one thing in common which goes beyond their path-dependent limits: it is the pursuit of economies of scale and scope to effectively compete in global financial markets. As practices and strategies of financial institutions on both sides of the Atlantic converge toward each other, financial regulatory systems of the United States and Europe will do the same.

Part II lays the groundwork for analysis and comparison with a discussion of the economics of universal banking and the reinstatement of the Glass-Steagall Act in the United States. Part III analyzes recent discussions for financial regulatory reform from a comparative perspective. It shows how the reform in the United States works on European infrastructures and highlights the practical differences. Germany and Switzerland will be the primary jurisdictions of interest. Part IV explores banks' corporate governance issues that search for solutions to

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[6] Johnathan Lynn, *Swiss Central Banker Backs Universal Bank Model-Paper*, REUTERS (Jan. 16, 2010), http://www.reuters.com/article/2010/01/16/swiss-banks-idUSLDE60F05020100116.

[7] *See* Georg Rich & Christian Walter, *The Future of Universal Banking*, 13 CATO J. 289 (1993). *See generally* BANKING, TRADE AND INDUSTRY: EUROPE, AMERICA AND ASIA FROM THE THIRTEENTH TO THE TWENTIETH CENTURY (Alice Teichova et al. eds., 1997); Panagiotis K. Staikouras, *Universal Banks, Universal Crises? Disentangling Myths from Realities in Quest of a New Regulatory and Supervisory Landscape*, 11 J. CORP. L. STUD. 139 (2011). For the Dutch system, see Christopher Louis Colvin, *Universal Banking Failure?: An Analysis of the Contrasting Responses of the Amsterdamsche Bank and the Rotterdamsche Bankvereeniging to the Dutch Financial Crisis of the 1920s* (London Sch. of Econ., Working Paper No. 98/07, 2007).

the problems large universal banks pose to economies. It illuminates the role of good corporate governance for banks in financial regulatory reform. It also suggests that the rules and practice in corporate governance of banks in the United States and Europe are converging. Part V touches on the issues of global regulatory reform to see if the global solution might fit into the structural issues of financial institutions and systems. It emphasizes the need to develop international rules for the structure of financial institutions and importance of comparative financial system and regulation. It also briefly discusses the allocation of regulatory authority. Part VI concludes.

II. UNIVERSAL BANKING IN THE UNITED STATES[8]

A. The Issue

Controversy over the separation of commercial and investment banks has been active since the outbreak of the global financial crisis in 2007. In popular terms, the issue is whether the United States should reinstate the Glass-Steagall Act of 1933.[9] The Act was passed after the Stock Market Crash of 1929 and the subsequent collapse of the American banking industry. The number of banks decreased from 25,000 to 14,000 during the crisis. The Act required the separation of commercial and investment banks in order to deter deposit-taking commercial banks from engaging in speculative and risky activities in the capital markets, which was believed to have been a major cause of the crash. It was not until 1999 when the Glass-Steagall Act was repealed by the Gramm-Leach-Bliley Act (GLBA).[10]

Twenty-five banks failed in 2008 and 140 banks failed in 2009 in the United States, whereas only eleven banks had failed between 2002 and 2007.[11]

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[8] *See generally* JORDI CANALS, UNIVERSAL BANKING: INTERNATIONAL COMPARISONS AND THEORETICAL PERSPECTIVES (1997); ANTHONY SAUNDERS & INGO WALTER, UNIVERSAL BANKING IN THE UNITED STATES: WHAT COULD WE GAIN? WHAT COULD WE LOSE? (1994); Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963 (2009).

[9] Erik M. Filipiak, *The Creation of a Regulatory Framework: The Enactment of Glass-Steagall* (Annual Meeting of the Am. Political Sci. Ass'n,. Meeting Paper, 2009).

[10] For the GLBA, see Jolina C. Cuaresma, *The Gramm-Leach-Bliley Act*, 17 BERKELEY TECH. L.J. 497 (2002); Joseph Karl Grant, *What the Financial Services Industry Puts Together Let No Person Put Asunder: How the Gramm-Leach-Bliley Act Contributed to the 2008-2009 American Capital Markets Crisis*, 73 ALB. L. REV. 371 (2010); Edward J. Janger & Paul M. Schwartz, *The Gramm-Leach-Bliley Act, Information Privacy, and the Limits of Default Rules*, 86 MINN. L. REV. 1219 (2002).

[11] *Failed Bank List*, FED. DEPOSIT INS. CORP., http://www.fdic.gov/bank/individual/failed/banklist.html (last visited Feb. 21, 2011).

The failure of the financial institutions during the 2008 crisis cast doubts on the conventional wisdom of "size matters." Economies of scale and scope can be a good thing in the competitive market, but they also create the so-called "Too-Big-To-Fail"[12] problem. Commercial banks' activities related to capital markets have become too risky and arguably contributed to the collapse of the U.S. and global financial markets. Should the United States go back to the Glass-Steagall era? Clearly, America cannot afford another Lehman Brothers failure[13] or Citigroup bailout. The systemic risk created by large financial institutions has become too big to manage.[14] The complexity and magnitude of business of the leading financial institutions have become too great to handle for any first-class managers.[15] The repeal of the Glass-Steagall Act created big financial institutions in the United States. Desegregation of commercial and investment banking activities led to increased mergers and acquisitions in the financial services industry. Some of the largest among them have become too big to fail. Their businesses are too complicated for any software. The number of employees is so large that illegal or questionable practices can neither be detected nor easily controlled. The leading financial institutions went global without sufficient resources to handle cultural diversities within the organization.[16] Like Japanese mega-banks[17] they may be overwhelmed by their own size.[18]

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[12] *See generally* ANDREW ROSS SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM—AND THEMSELVES (2009).

[13] For general background on the failure of Lehman Brothers in 2008, *see generally* LAWRENCE G. MCDONALD, A COLOSSAL FAILURE OF COMMON SENSE (2009); JOSEPH TIBMAN, THE MURDER OF LEHMAN BROTHERS: AN INSIDER'S LOOK AT THE GLOBAL MELTDOWN (2009); MARK T. WILLIAMS, UNCONTROLLED RISK (2010) .

[14] *See* George G. Kaufman, *Bank Failures, Systemic Risk, and Bank Regulation*, 16 CATO J. 17 (1996); Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193 (2008). *See also* KERN ALEXANDER ET AL., GLOBAL GOVERNANCE OF FINANCIAL SYSTEMS: THE INTERNATIONAL REGULATION OF SYSTEMIC RISK (2006).

[15] *See* Alan Greenspan, *Dodd-Frank Fails to Meet Test of Our Times*, FIN. TIMES (March 29, 2011, 6:31 PM ET), http://www.ft.com/cms/s/0/14662fd8-5a28-11e0-86d3-00144feab49a.html ("[R]egulators, and for that matter everyone else, can never get more than a glimpse at the internal workings of the simplest of modern financial systems").

[16] Harold James, *Why Big Banks Will Get Bigger*, PROJECT SYNDICATE, (Jan. 5, 2010), http://www.project-syndicate.org/commentary/james36/English.

[17] *See* Arthur E. Wilmarth, Jr., *Too Good To Be True? The Unfulfilled Promises Behind Big Bank Mergers*, 2 STAN. J.L. BUS. & FIN. 1 (1995).

[18] Banks expand their businesses internationally. Small economies, however, may face difficulties if their banks become too big for the size of their economies. Ireland and Iceland are good examples. Their banks grew big and went international out of the government's effective

B. A Brief Chronology[19]

1. Early Years

The modern banking business originated in Italy, representatively by the House of Medici in the 14th century, preceded by Bardi and Peruzzi of Florence.[20] The Italian mathematician Fibonacci (c. 1170–c. 1250) came up with a new method of calculating interest, and that stimulated lending which in turn supported trade.[21] It is not coincidental that Shakespeare's *The Merchant of Venice* was about the merchants of the 14th century. Soon, the rise of the merchant banks followed.[22] Merchant banks stayed in close relationship with industrial firms through trade finance, commercial papers and equity investments. The deposit-taking commercial banks are the products and/or companions of these merchant banks. So, the universal bank can be said to not be a special category of bank; rather, it is the original form of doing banking business, with the only exception being in England where banks took almost no equity participation in industrial firms.[23]

Baring Bank is said to be the oldest significant merchant bank in history.[24] It was founded in England in 1762. By the early 19th century, Baring

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control. As a result, the global financial crisis brought their economies down. James, *supra* note __.

[19] *See* VINCENT CAROSSO, INVESTMENT BANKING IN AMERICA: A HISTORY (1970); CHARLES R. GEISST, WALL STREET: A HISTORY (1997); ALAN D. MORRISON & WILLIAM J. WILHELM, JR., INVESTMENT BANKING: INSTITUTIONS, POLITICS, AND LAW (2007); JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET (3rd ed. 2003).

[20] *See* RAYMOND W. GOLDSMITH, PREMODERN FINANCIAL SYSTEMS: A HISTORICAL COMPARATIVE STUDY 145–70 (1987); CHRISTOPHER HIBBERT, THE HOUSE OF MEDICI: ITS RISE AND FALL (1999); TIM PARKS, MEDICI MONEY (2006). Arguably, the first global financial institution was the Knights Templar. The Templar, Inc. is said to have invented the bill of exchange and even financed King Louis VII of France in the second crusade. *See* JACK CASHILL, POPES & BANKERS: A CULTURAL HISTORY OF CREDIT & DEBT, FROM ARISTOTLE TO AIG 33–40 (2010); MICHAEL HAAG, THE TEMPLARS: THE HISTORY & THE MYTH 137–44 (2009). For a history of the Order, *see generally* MALCOLM BARBER, THE NEW KNIGHTHOOD: A HISTORY OF THE ORDER OF THE TEMPLE (1995); MICHAEL HAAG, THE TEMPLARS: THE HISTORY AND THE MYTH: FROM SOLOMON'S TEMPLE TO THE FREEMASONS (2009).

[21] *See* NIALL FERGUSON, THE ASCENT OF MONEY: A FINANCIAL HISTORY OF THE WORLD 33–34 (2008).

[22] *Cf.* ERIK BANKS, THE RISE AND FALL OF THE MERCHANT BANKS (1999); STANLEY CHAPMAN, THE RISE OF MERCHANT BANKING (2006).

[23] MICHEL FLEURIET, INVESTMENT BANKING EXPLAINED 5 (2008).

[24] *See* DAVID S. LANDES, DYNASTIES: FORTUNES AND MISFORTUNES OF THE WORLD'S GREAT FAMILY BUSINESSES 13-36 (2006).

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became the most influential bank in Europe. It grew fast through the revolution and war financing of British governments. Baring even brokered France's sale of the State of Louisiana to the United States in 1803. After Rothschild's takeover of the dominant position in European banking by 1820, Baring's business shrank. It, however, maintained its reputation as the oldest merchant banking house in Europe.[25] Rothschild, which started as a competitor to Baring Bank, surpassed Baring in the early 19th century.[26] Like Baring, Rothschild also grew through financing activities for dynasties and sovereign governments, particular during times of war. It was the absolute financial power through the 19th century. More importantly, it practically midwifed the investment banking industry in the United States through its agents, most notably August Belmont, who sold railroad bonds issued by the U.S. firms in Europe.

After the Civil War, the early investment bankers began to underwrite U.S. railroad stocks to finance the huge industry. They then began to buy and distribute the stocks to European investors.[27] This was when the American model of investment banking emerged. They were J.P. Morgan and Company, JW Seligman and Company, Kuhn Loeb, Kidder Peabody, and PaineWebber. An oligopolistic industry was born, with J.P. Morgan being the market leader.[28] The "new generation" house Goldman Sachs was founded only in 1869 by Marcus Goldman and became a member of the New York Stock Exchange in 1896. Goldman Sachs established a solid alliance with Lehman Brothers, which was founded a little earlier in 1850.[29]

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[25] During World War II, the British government again relied upon Baring in securing financing for war. In 1995, however, one of Baring's employees in Singapore lost 1.4 billion dollars in speculative trade. Baring ended up being sold to the Dutch ING for one pound. It finally disappeared in 2001 after 250 years of history.

[26] *See* NIALL FERGUSON, 1 THE HOUSE OF ROTHSCHILD: MONEY'S PROPHETS: 1798-1848 (1998); NIALL FERGUSON, 2 THE HOUSE OF ROTHSCHILD: THE WORLD'S BANKER: 1849-1999 (1998).

[27] *But see* JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 253-54 (2006) (pointing out that "it was not until 1928 that the total value of publicly traded equity exceeded that of outstanding debt").

[28] Kidder Peabody was established in 1865 and sold to General Electric in 1986, then to PaineWebber in 1994. PaineWebber was then merged with UBS in 2000. Kuhn Loeb was founded in 1867 and became the principal rival of J.P.Morgan. But, the house lost significance after World War II and was sold to Lehman Brothers in 1977. Lehman Brothers Kuhn Loeb was acquired by American Express in 1984 forming Shearson Lehman American Express.

[29] For a history of Goldman Sachs, *see* CHARLES D. ELLIS, PARTNERSHIP: THE MAKING OF GOLDMAN SACHS (2009), LISA ENDLICH, GOLDMAN SACHS: THE CULTURE OF SUCCESS (1997), and SUZANNE MCGEE, CHASING GOLDMAN SACHS (2010). For a history of Lehman Brothers, *see* PETER CHAPMAN, THE LAST OF THE IMPERIOUS RICH: LEHMAN BROTHERS, 1844-2008 (2010).

2. J.P. Moragn and the Glass-Steagall

John Coffee suggested that investment bankers took the role of guardians for public investors in the early stages of industrialization in the United States.[30] When we read Edward Rock's fascinating description of the age of robber barons,[31] it makes perfect sense that American investors badly needed investment bankers. Railroad companies did not protect minority shareholders through corporate governance devices. To the contrary, control group quite often manipulated stock prices. Through corporate governance mechanisms, investment banks devised a way to credibly make promises to potential investors. For instance, they had directorships in many banks and general corporations to monitor managers and businesses.[32]

However, the investment banking industry led by J.P. Morgan was soon feared by the public as it grew too fast and powerful.[33] J.P. Morgan controlled the entire financial services industry of the time, banking, securities and insurance included. The financial firms in turn controlled industrial firms. The Pujo Committee was created in 1912, and the industry was ultimately reorganized by the Glass-Steagall Act of 1933.[34] Commercial banking and investment banking were separated for very political reasons.[35] President Theodore Roosevelt's antagonism against the financial industry symbolized by J.P. Morgan played a crucial role in the process.[36] Americans feared that the financial giant may jeopardize democracy.[37] J.P. Morgan ended up splitting into Morgan Guaranty

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[30] John C. Coffee, Jr., *Dispersed Ownership: The Theories, the Evidence, and the Enduring Tension Between 'Lumpers' and 'Splitters'* (European Corporate Governance Inst., Working Paper No. 144/2010, 2010).

[31] Edward B. Rock, *Encountering the Scarlet Woman of Wall Street: Speculative Comments at the End of the Century*, 2 THEORETICAL INQUIRIES L. 237 (2001).

[32] *See* John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Role of Law in the Separation of Ownership and Control*, 111 YALE L.J. 1, 27 – 32 (2001).

[33] *See* RON CHERNOW, THE HOUSE OF MORGAN: AN AMERICAN BANKING DYNASTY AND THE RISE OF MODERN FINANCE (1990); JEAN STROUSE, MORGAN: AMERICAN FINANCIER (2000).

[34] *See generally* GEORGE J. BENSTON, THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING: THE GLASS-STEAGALL ACT REVISITED AND RECONSIDERED (1990).

[35] *Cf.* MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT (2003); MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994); Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000).

[36] LANDES, *supra* note __, at 85–86.

[37] Ironically, public opinion in the United States urged J.P. Morgan Chase to rescue Bear Stearns in 2008. Cashill, *supra* note __, at 228. For background on J.P. Morgan Chase, *see*

Trust, Morgan Stanley,[38] and Morgan Grenfell of London. However, it is not clear if universal banking contributed to the failure of banks during the Great Depression. The U.S. system did not allow banks to do business outside of the place of their establishment because of the public sentiment that local money should go to local borrowers.[39] That prevented American banks from growing large and small banks were inherently vulnerable to economic crisis.

The Glass-Steagall Act experienced continuous erosion in its normative power over the years. The U.S. banking industry regarded the Act as a roadblock in its fierce competition with the European universal banks in the global financial markets that were characterized by world-wide mergers and acquisitions.[40] The economies of scope could not be achieved because of the Act. At the same time, investment banks started to eat away at the traditional businesses of commercial banks. Junk bonds replaced commercial loans in the 1980s[41] due to the rapid growth of private equity and leveraged buyouts.[42] The growth of the mutual fund market was also a huge blow to commercial banks' lending business. So, banks became offensive and expanded their business into the capital markets, challenging the Glass-Steagall Act. Most notably, banks began securities brokerage and asset management services. Litigation followed. Voluminous case law and practice were developed in this area. The Supreme Court of the United

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MCDONALD, DUFF, LAST MAN STANDING: THE ASCENT OF JAMIE DIMON AND JPMORGAN CHASE (2009).

[38] *Cf.* PATRICIA BEARD, BLUE BLOOD AND MUTINY: THE FIGHT FOR THE SOUL OF MORGAN STANLEY (2007).

[39] *See* HOWARD BODENHORN, STATE BANKING IN EARLY AMERICA: A NEW ECONOMIC HISTORY (2003).

[40] *See* Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975 – 2000: Competition, Consolidation, and Increased Risks*, U. ILL. L. REV. 215–476 (2002).

[41] MORRISON & WILHELM, *supra* note __, at 295–96.

[42] *See generally* GEORGE ANDERS, MERCHANTS OF DEBT: KKR AND THE MORTGAGING OF AMERICAN BUSINESS (1992); GEORGE P. BAKER & GEORGE DAVID SMITH, THE NEW FINANCIAL CAPITALISTS: KOHLBERG KRAVIS ROBERTS AND THE CREATION OF CORPORATE VALUE (1998); BRYAN BURROUGH & JOHN HELYAR, BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO (1991); HARRY CENDROWSKI ET AL., PRIVATE EQUITY: HISTORY, GOVERNANCE, AND OPERATIONS (2008); PETER G. PETERSON, THE EDUCATION OF AN AMERICAN DREAMER (2009);Brian Cheffins & John Armour, *The Eclipse of Private Equity*, 33 DEL. J. CORP. L. 1 (2008).

States approved Bank of America's acquisition of Charles Schwab in 1984[43] and Bankers Trust's commercial paper underwriting business in 1986.[44]

3. The Gramm-Leach-Bliley and Industry Consolidation

The 1998 the merger of Citicorp and Travelers highlighted the trend.[45] Citigroup, the largest financial services company in the world, was created through the stock swap merger of Travelers (which owned SalomonSmithBarney) and Citicorp, the parent of Citibank. Finally, in 1999, the Gramm-Leach-Bliley Act was passed and partially repealed the Glass-Steagall Act with the backing of Alan Greenspan and the Clinton administration. The GLBA allowed commercial banks to engage in the securities and insurance businesses.[46]

Since the repeal of the Glass-Steagall Act, commercial banks have aggressively pursued the highly profitable investment banking business. Commercial banks cited the following reasons for pursuing new fee-based businesses: first, they felt compelled to offer one-stop shopping for existing clientele; second, it was regarded as a necessary step to compete with European universal banks not restrained by regulations; third, cross-selling platforms appeared attractive; fourth, apparent cost savings were available through leveraging the existing client and industry knowledge base; and fifth, as competition intensified, they could provide credit to win capital markets business.[47] On the side of investment banking business, spreads narrowed and, accordingly, economies of scale increased. Computers and information technologies became increasingly powerful and sophisticated, specialized investment banking houses badly needed capital to operate at a commercial scale. Some of them were absorbed by commercial banks.[48]

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[43] Sec. Indus. Ass'n v. Bd. of Governors, 468 U.S. 137 (1984); John S. Zieser, Note, *Security Under the Glass-Steagall Act: Analyzing the Supreme Court's Framework for Determining Permissible Bank Activity*, 70 CORNELL L. REV. 1194 (1985).

[44] *See* Donald C. Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672 (1987).

[45] *See* AMEY STONE & MIKE BREWSTER, KING OF CAPITAL: SANDY WEILL AND THE MAKING OF CITIGROUP 229 (2002).

[46] *See* Faith Neale & Pamela Peterson, *The Effect of the Gramm-Leach-Bliley Act on the Insurance Industry* (Fla. State Univ., Working Paper, 2003).

[47] *See* PowerPoint, William T. Sherman, *Conditions and Trends in the Investment Banking Industry: Presentation to the World Services Group, Inc.*, WORLD SERVICES GROUP 8 (May 7, 2004), http://www.worldservicesgroup.com/powerpoint/Sherman.ppt.

[48] *See* MORRISON & WILHELM, *supra* note __, at 279.

Only a couple of industry leaders remain solely focused on investment banking. Universal banks appear to be better positioned given their size and access to capital; however, such pure investment banks like Goldman Sachs and Lehman Brothers have maintained their market share since 1996. Universal banks like Citigroup and J.P. Morgan Chase experienced difficulty in integrating and aligning banking, sales and trading, and research. Pure investment banks were also well capitalized and were not handicapped for lack of capital (i.e. block trades) because most of them went public,[49] and credit relationships both helped and hurt.[50]

C. Reinstatement of the Glass-Steagall Act?

Much has been written on the global financial crisis.[51] This is not the place to repeat it. The financial crisis of 2008 occurred when banks and other financial institutions took huge risks. Several of the world's oldest and largest financial institutions collapsed or were on the verge of doing so. Government bailouts followed, but markets plummeted and credit dried up. The whole financial system was led to near collapse. Financial products like credit default swaps and other financial derivatives became the target of public outrage. The crisis ignited discussions on the business model of financial services firms as it relates to the soundness of the financial system and the safety of the entire economy. As the crisis was international in nature, discussions have been made worldwide through international stages like the G20.

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[49] *See id.*, at 237 – 238. For the IPO of Goldman Sachs, *see* ENDLICH, *supra* note __, at 415 – 426.

[50] Sherman, *supra* note __, at 13.

[51] *See generally* WILLIAM D. COHAN, HOUSE OF CARDS (2009); STEVEN M. DAVIDOFF, GODS AT WAR (2009); DAVIS POLK & WARDWELL LLP, FINANCIAL CRISIS MANUAL: A GUIDE TO THE LAWS, REGULATIONS AND CONTRACTS OF THE FINANCIAL CRISIS (2009); ALAN C. GREENBERG, THE RISE AND FALL OF BEAR STEARNS (2010); ROGER LOWENSTEIN, THE END OF WALL STREET (2010); DUFF MCDONALD, LAST MAN STANDING: THE ASCENT OF JAMIE DIMON AND JPMORGAN CHASE (2009); HENRY M. PAULSON, JR., ON THE BRINK (2010); ANDREW SHENG, FROM ASIAN TO GLOBAL FINANCIAL CRISIS (2009); GILLIAN TETT, FOOL'S GOLD (2009); DAVID WESSEL, IN FED WE TRUST (2009); Richard Squire, *Shareholder Opportunism in a World of Risky Debt*, 123 HARV. L. REV. 1151 (2010); John C. Coffee, *What Went Wrong? An Initial Inquiry into the Causes of the 2008 Financial Crisis*, 9 J. CORP. L. STUD. 1 (2009). For German literature on the global financial crisis, see Bernd Rudolph, *Die internationale Finanzkrise: Ursachen, Treiber, Veränderungsbedarf und Reformansätze*, 39 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 1 (2010) (Ger.). For the author's account in the Korean language on which some parts of this article draws, *see* Kim Hwa-Jin, *Eunhaeng-ui jibaegujo-wa eunhaeng isa-ui bupryuljeog chaeg-im* [*Corporate Governance of Banks and Bank Director Liability*], 51-4 SEOUL L.J. 151 (2010) and Kim Hwa-Jin, *Geul-lobeol geum-yung-wigi-wa geum-yungsan-eob-ui gujojaepyeon* [*The Financial Services Industry in the Global Financial Crisis: History and Strategies*], 51-3 SEOUL L.J. 125 (2010).

1. Pros

Many blame the repeal of the Glass-Steagall Act as one factor leading to the financial crisis.[52] They believe that allowing commercial and investment banks to combine led to the current crisis, and that re-mandating separation would prevent a repeat of the financial crisis.[53] Allowing commercial banks to engage in risky capital market related activities, while protecting them from failure through deposit insurance and access to the Federal Reserve Bank's discount window, created a moral hazard problem[54] and an appetite for larger risks. Therefore, "some kind of separation between institutions that deal primarily in the capital markets and those involved in more traditional deposit-taking and working-capital finance makes sense."[55]

Another argument in favor of reinstating the Glass-Steagall Act is that conflicts of interest may become more serious when commercial and investment banking activities are consolidated into a single financial institution,[56] considering that conflicts of interest is by far the single most important issue for big investment banks.[57] Conflicts of interest within big banks are too complicated

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[52] *See, e.g.*, Nouriel Roubini & Arnab Das, *Solutions for a Crisis in Its Sovereign Stage*, FIN. TIMES (May 31, 2010), http://www.ft.com/cms/s/0/8eda2c3e-6cde-11df-91c8-00144feab49a.html.

[53] *See* Louis Uchitelle, *Elders of Wall St. Favor More Regulation*, N.Y. TIMES, Feb. 17, 2010, at B1

[54] John H. Boyd et al., *Moral Hazard Under Commercial and Universal Banking*, 30 J. MONEY, CREDIT & BANKING __ (1998).

[55] David Wessel, *John Reed on Glass Steagall: Then and Now*, Blog post on *Real Time Economics*, WALL ST. J. (Oct. 27, 2009, 4:27 PM ET), http://blogs.wsj.com/economics/2009/10/27/john-reed-on-glass-steagall-then-now/.

[56] *See* Georg Rich & Christian Walter, *The Future of Universal Banking*, 13 CATO J. 289, 306 (1993). For conflicts of interest, see generally ANDREW CROCKETT ET AL., CONFLICTS OF INTEREST IN THE FINANCIAL SERVICES INDUSTRY: WHAT SHOULD WE DO ABOUT THEM? (2003); Daylian M. Cain, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*, 34 J. LEGAL STUD. 1 (2005); Susanna Leong, *Protection of Confidential Information Acquired from a Former Client: Are Chinese Walls Adequate?*, 11 SING. ACAD. L.J. 444 (1999); Norman S. Poser, *Conflicts of Interest Within Securities Firms*, 16 BROOK. J. INT'L L. 111 (1990); Andrew Tuch, *Investment Banks as Fiduciaries: Implications for Conflicts of Interest*, 29 MELB. U. L. REV. 478 (2005); Peter G. Klein & Kathrin Zoeller, *Universal Banking and Conflicts of Interests: Evidence from German Initial Public Offerings* (Contracting & Org. Research Inst., Working Paper No. 03-06, 2003).

[57] For conflicts of interest issues in takeovers, *see* Klaus J. Hopt, *Takeovers, Secrecy, and Conflicts of Interest: Problems for Boards and Banks* (European Corporate Governance Inst., Working Paper No. 03/2002, 2002) and Charles W. Calomiris & Hal J. Singer, *How Often Do "Conflicts of Interests" in the Investment Banking Industry Arise During Hostile Takeovers?* (Feb.

to control successfully. There are many empirical studies that support the conflicts of interest concern.[58]

Also, segregation of commercial and investment banking activities may be the way to address behavioral factors that can lead to global financial chaos. It is argued that segregation is the only way to prevent socio-psychological aspects of market behavior from leading to homogenization in global financial markets.[59] Segregating financial institutions along business lines would prevent homogenization of financial markets on an international level, and thus reduce the potential for a local financial crisis to grow into a global one.[60]

2. Cons

Conventional wisdom is that universal banks can provide consumers with a greater range of services and tend to have greater capital reserves to protect consumers against unanticipated losses. The universal banking structure provides economies of scale and scope to banks that enable them to offer services to customers at a lower price.[61] It creates synergies as the use of deposits as a cheap source of funds may be employed across the border of the commercial banking business.[62] Universal banks are also better able to diversify risk. So some economists, banks, and powerful financial lobbies, including the Committee on

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24, 2004) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=509562.

[58] *See* Wolfgang Bessier & Matthias Stanzel, *Conflicts of Interest and Research Quality of Affiliated Analysts in the German Universal Banking System: Evidence from IPO Underwriting*, 15 EUR. FIN. MGMT. 757 (2009); Hedva Ber et al., *Conflict of Interest in Universal Banking: Bank Lending, Stock Under-writing, and Fund Management* Abstract (Ctr. For Econ. Policy Research, Discussion Paper No. 2359, 2000); Klein & Zoeller, *supra* note 52., *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=223085;

[59] *See* Emilios Avgouleas, *The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy*, 9 J. CORP. L. STUD. 23 (2009). Avgouleas explains homogenization as "the widespread tendency of market players to move all in the same direction at once." *Id.* at 28. Homogenization harms global financial markets by leading to "marked lack of pluralism in trading strategies and investment diversification, significantly increasing endogenous risk" and "depriv[ing] the global financial system from the balance provided by investment and financial activity diversification." *Id.* at 48.

[60] *See* Avgouleas, *supra* note 55, at 48.

[61] Even commercial firms try to enter into the financial services industry. *See* Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN. L. REV. 1539 (2007) (urging Congress to enact legislation to prohibit acquisitions of FDIC-insured industrial loan companies by commercial firms).

[62] INT'L BAR ASS'N, TASK FORCE ON THE FINANCIAL CRISIS, A SURVEY OF CURRENT REGULATORY TRENDS 23 (2010) [hereinafter 'IBA Report'].

Capital Markets Regulation[63] and Paul Krugman,[64] argue against regulation that newly requires the separation of commercial and investment banking. It has been strongly suggested that there is no connection between the failure of universal banking and the financial crisis. The U.S. banks failed due to the deterioration of their commercial banking businesses. Reinstating the Glass-Steagall divide would be unnecessary for financial reform because repeal of the Act neither caused nor worsened the financial crisis.[65] After all, it was the bad lending practices and the subprime mortgage business, the core of commercial banking, that served as the primary causes of the financial crisis.[66] Regulations must therefore target bad lending practices that lie at the root of the financial crisis.

Although the Glass-Steagall Act[67] prohibited commercial banks from underwriting or dealing in mortgage-backed securities (MBS), the Act never prohibited commercial banks from buying and selling MBS as investment securities.[68] Thus, banks suffered losses from acting in their capacity as commercial banks, not from acting as securities firms. GLBA simply permitted securities firms and commercial banks to be affiliated with each other. It is unlikely that a bank securities affiliate or subsidiary of a commercial bank could significantly harm the financial condition of the commercial bank.[69] To be sure, the expansion of commercial banks' business areas over the years was also made possible through market practices and permissive policies of the administration and judiciary while the Glass-Steagall Act was still in force. Therefore, it may well be argued that the differences in detail between the Glass-Steagall and GLBA[70] are not significant. However, the repeal of Glass-Steagall, if not in its entirety, could have sent certain signals to the market and industries. The financial

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[63] COMM. ON CAPITAL MKTS. REGULATION, THE GLOBAL FINANCIAL CRISIS: A PLAN FOR REGULATORY REFORM 191–95 (2009).

[64] Paul Krugman, *Glass-Steagall, Part Deux*, Blog post on *The Conscience of a Liberal*, N.Y. TIMES(Jan. 21, 2010, 5:00 PM), http://krugman.blogs.nytimes.com/2010/01/21/glass-steagal-part-deux/.

[65] Peter J. Wallison, *Did the "Repeal" of Glass-Steagall Have Any Role in the Financial Crisis? Not Guilty. Not Even Close* 14–15 (Networks Fin. Inst. at Ind. State U., Policy Brief 2009-PB-09, 2009).

[66] HAL S. SCOTT, THE GLOBAL FINANCIAL CRISIS 108–09 (2009).

[67] For a good summary, *see* Ehud Ofer, *Glass-Steagall: The American Nightmare That Became the Israeli Dream*, 9 FORDHAM J. CORP. & FIN. L. 527, 528–42 (2004).

[68] Wallison, *supra* note 4, at 6.

[69] *Id.* at 16-17.

[70] For a good summary, *see* Ofer, *supra* note __, at 543–50.

services industry may have taken advantage of the changes. In practice, 100 percent-owned subsidiaries may be run as business units within one firm.

The conflicts of interest problem with universal banking may have been exaggerated, and can be controlled through proper regulatory measures.[71] One study shows that the conflicts of interest issue that was controversial at the time of the enactment of Glass-Steagall was in fact exaggerated.[72] It goes further and argues that the universal banking system was more effective in controlling the conflicts of interest because of the sensitivity of universal banks' reputation.[73]

Opponents of reinstating Glass-Steagall propose such alternative forms of financial regulation to further financial reform as limiting the amount of assets a single financial institution may hold and to increase capital requirements of financial institutions. Regulation should also focus on banks' risk-taking activity, not on the size, and should mandate higher capital requirements relative to risk-taking activity and impose limits on leverage ratios.[74] Canada is a good example of that approach. Proponents of universal banking, *i.e.*, opponents of reinstating Glass-Steagall, highlight Canada as evidence that universal banking does not have inherent structural weaknesses and would not necessarily lead to financial crisis. Canada adopts the universal banking model, and Canada's banking industry is dominated by five large banks that represent ninety percent of the market.[75] However, no Canadian bank failed during the global financial crisis. This can be attributed to alternative forms of regulation, including tighter lending standards, lower leverage ratios, and better regulatory oversight.[76]

D. The Volcker-Rule

1. A Compromise

Section 619 of the Dodd-Frank Act is also known as the Merkley-Levin provisions on proprietary trading and conflicts of interest or simply as the "Volcker Rule."[77] It adds a new Section 13 to the Bank Holding Company Act of

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[71] BENSTON, *supra* note __, at 309–10.

[72] *Id.* at 43–122.

[73] *Id.* at 205–11.

[74] *Big Banks Needn't Be Bad Banks*, ECON. TIMES (Feb. 5, 2010), http://economictimes.indiatimes.com/news/international-business/big-banks-neednt-be-bad-banks/articleshow/5536770.cms.

[75] *Id*.

[76] *Id*.

[77] *See generally*, Andrew F. Tuch, *Conflicted Gatekeepers: The Volcer Rule and Goldman*

1956. Former Federal Reserve Chairman Paul Volcker believed that commercial banks' risk-taking activities needed to be constrained. He had been arguing that commercial banks should be prevented from taking advantage of the safety net provided by the government to make speculative investments.[78] Volcker proposed a new financial reform, which restores the "spirit" of the Glass-Steagall Act, but not the Act itself.[79] President Obama endorsed this reform and named it the "Volcker Rule." Rather than recreating a wall between commercial and investment banking, the Volcker Rule forbids commercial banks from owning or investing in hedge funds, private equity funds, and from engaging in proprietary trading.[80] According to Simon Johnson, "[m]ismanagement of risks that involved effectively betting the banks' own capital was central to the financial crisis of 2008."[81] The Volcker Rule would "significantly reduce systemic financial risks looking forward." Furthermore, the "separation between banks and the funds they sponsor, in any fashion, needs to be complete."[82] President Obama articulated the thinking behind the rule:

> "[W]e should no longer allow banks to stray too far from their central mission of serving their customers. In recent years, too many financial firms have put taxpayer money at risk by operating hedge funds and private equity funds and making riskier investments to reap a quick reward. And these firms have taken these risks while benefiting from special financial privileges that are reserved only for banks. Our government provides deposit insurance and other safeguards and

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Sachs (Harvard Law School John M. Olin Center Discussion Paper No. 37, April 2011), http://ssrn.com/abstract=1809271.

[78] *See* David Cho & Binyamin Appelbaum, *Obama's 'Volcker Rule' Shifts Power Away from Geithner*, WASH. POST (Jan. 22, 2010), http://www.washingtonpost.com/wp-dyn/content/article/ 2010/01/21/AR2010012104935.html?sid=ST2010012104948.

[79] *See* Damian Paletta & Jonathan Weisman, *Proposal Set to Curb Bank Giants*, WALL ST. J. (Jan. 21, 2010, 1:16 PM ET), http://online.wsj.com/article/SB10001424052748704320104575015910344117800.html.

[80] It provides that no "banking entity" may "acquire or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund." The Volcker-Rule is expected to become effective on July 21, 2012. *See* CLIFFORD CHANCE, IMPACT OF THE "VOLCKER RULE" ON NON-U.S. BANK INVESTMENTS IN PRIVATE EQUITY AND HEDGE FUNDS OUTSIDE THE UNITED STATES 2 (2010). For proprietary trading, *see generally* MIKE BELLAFIORE, ONE GOOD TRADE: INSIDE THE HIGHLY COMPETITIVE WORLD OF PROPRIETARY TRADING (2010).

[81] *See* SIMON JOHNSON & JAMES KWAK, THIRTEEN BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN (2010).

[82] Letter from Simon Johnson, Ronald A. Kurtz Professor of Entrepreneurship, Massachusetts Insitute of Technnology, to the Members of the Financial Stability Oversight Council (November 5, 2010).

> guarantees to firms that operate banks. We do so because a stable and reliable banking system promotes sustained growth, and because we learned how dangerous the failure of that system can be during the Great Depression. But these privileges were not created to bestow banks operating hedge funds or private equity funds with an unfair advantage. When banks benefit from the safety net that taxpayers provide –- which includes lower-cost capital –- it is not appropriate for them to turn around and use that cheap money to trade for profit. And that is especially true when this kind of trading often puts banks in direct conflict with their customers' interests. The fact is, these kinds of trading operations can create enormous and costly risks, endangering the entire bank if things go wrong. We simply cannot accept a system in which hedge funds or private equity firms inside banks can place huge, risky bets that are subsidized by taxpayers and that could pose a conflict of interest. And we cannot accept a system in which shareholders make money on these operations if the bank wins but taxpayers foot the bill if the bank loses."[83]

The Volcker Rule requires that large banks cease to conduct proprietary trading and significantly limit their private-fund investments to three percent of the Basel II Tier 1 capital. The original version of the Rule stipulated a total ban on commercial banks' private-fund investments. Banks have at maximum a seven-year grace period to comply with the Rule. Commercial banks can do certain derivative businesses only through their subsidiaries although this is not included in the Volcker Rule.[84]

As for the restructuring of the financial services industry, President Obama articulated the thinking behind a rule that limits the size of single financial institution:

> "[A]s part of our efforts to protect against future crises, I'm also proposing that we prevent the further consolidation of our financial system. There has long been a deposit cap in place to guard against too much risk being concentrated in a single bank. The same principle should apply to wider forms of funding employed by large financial institutions in today's economy. The American people will not be served

[83] *See supra* note 2.

[84] For a good summary, *see* Bradley K. Sabel, *Volcker Rule Continues to Garner Outsized Attention*, THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (October 31, 2010, 9:46 AM), http://blogs.law.harvard.edu/corpgov/2010/10/31/volcker-rule-continues-to-garner-outsized-attention/.

> by a financial system that comprises just a few massive firms. That's not good for consumers; it's not good for the economy. And through this policy, that is an outcome we will avoid."[85]

The Volcker Rule includes the measures that curb the size of banks.[86] Mergers and acquisitions amongst banks will be allowed only to the extent that combined liabilities did not exceed ten percent of the entire liabilities of all banks. This rule in fact may raise concern outside the United States in terms of mergers and acquisitions.[87] However, most mergers and acquisitions would not surpass the rule.[88]

2. International Reach

The Volcker Rule covers both U.S. banking groups and non-U.S. banking groups with U.S. banking operations.[89] The rule applies to "banking entities." A banking entity includes any company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978 and any subsidiary or affiliate of that entity, *e.g.*, foreign banks with U.S.-based branches and agencies. Accordingly, the rule affects virtually every major commercial and investment bank worldwide.[90] To be sure, as there is no ability for a U.S. institution to shift business abroad to avoid the rule, foreign institutions might enjoy an advantage if they do business solely outside the United States.[91] Alan Greenspan also has recently pointed out that U.S. offices of foreign institutions could readily switch proprietary trading to European and Asian, even Canadian

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[85] *See supra* note 2.

[86] *See generally* Michael J. Aiello & Heath P. Tarbert, *Bank M&A in the Wake of Dodd-Frank*, 127 BANKING L. J. 909 (2010).

[87] How compliance with the Volcker Rule should be monitored and enforced is also a big question. *See* Simon Johnson, *Proprietary Traders Earn `Trust, but Verify*,' BLOOMBERG (Oct. 7, 2010, 9:00 PM ET), http://www.bloomberg.com/news/2010-10-08/proprietary-traders-earned-trust-but-verify-simon-johnson.html.

[88] *See* Matthew Richardson et al., *Large Banks and the Volcker Rule*, in: REGULATING WALL STREET: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE 181, 196 (VIRAL V. ACHARYA ET AL. EDS., 2011) (noting that only Bank of America and JPMorgan Chase were to reach the threshold).

[89] The Dodd-Frank Act has been criticized for neglecting the international dimensions of the new financial order. *See* DAVID A. SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES 175–76 (2010).

[90] Sabel, *supra* note __.

[91] *Id. See also*, Richardson et al., *supra* note __, at 207.

banks.[92] Also, non-U.S. financial institutions covered by the Volcker Rule would generally be allowed to continue making investments and conduct private equity and hedge fund operations outside the United States if they are not controlled by a U.S. institution and do not sell ownership interest in the private equity or hedge fund to a U.S. resident.[93]

However, any significant non-U.S. financial institution has business interests in one way or another within the United States. Therefore, the Volcker Rule would have greater impact on the businesses of non-U.S. financial institutions than the Sarbanes-Oxley Act of 2002 did on the corporate governance of non-U.S. firms. Non-U.S. firms listed on a U.S. stock exchange are exempt from many, though not all, of the corporate governance requirements under the Sarbanes-Oxley Act, provided that they disclose the differences between their home country corporate governance practices compared to those applicable to U.S. companies.[94] Such exemptions may not be available under the Dodd-Frank Act because it is not about foreign securities listed on a U.S. stock exchange, but about doing actual business in the United States.

III. UNIVERSAL BANKING IN EUROPE

In the United States, the basic institutional framework established by the GLBA that allows universal banking will remain valid notwithstanding the new constraints introduced by the Volcker-Rule. The U.S. financial institutions will keep moving toward universal banking to achieve economies of scale and scope as soon as the restructuring of the financial services industry becomes complete. The discussions below put the developments in the United States in comparative perspective with the European system.

A. A European Volcker-Rule?

When the U.S. plan, including the Volcker Rule, was first publicized in early 2010, European Union finance ministers opposed the U.S. proposal to limit banks' size and risk-taking. The Volcker Rule in the European Union might not be consistent with the current principles of the internal market and universal banking.[95] The Credit Institutions Directive of 2000 clearly adopted the universal

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[92] *See* Greenspan, *supra* note __.

[93] For detailed discussions, *see* CLIFFORD CHANCE, *supra* note __ and Sabel, *supra* note __.

[94] *See, e.g.*, SEC Rule 10A-3(b)(iv), 10A-3(c).

[95] Meera Louis & Jurjen van de Pol, *EU Finance Ministers to Resist Obama Plans for Banking Overhaul*, BLOOMBERG BUS. WK. (Feb 14, 2010, 6:42 PM EST), http://www.businessweek.com/news/2010-02-14/eu-finance-ministers-to-resist-obama-plans-for-banking-overhaul.html. According to Simon Johnson, Europe faced serious difficulties because of failures

banking model in the European Union.[96] In particular, the British Financial Services Minister Paul Myners suggested that he would prefer a capital requirement approach like the Basel Committee rules to the structural changes proposed by the United States to address risky bank trading activities. Curbing the size of big banks was not the best way to make the system safer.[97] Germany and France also signaled that they would not follow the U.S. guidelines, raising concerns about banks coming to Europe to conduct their risky activities.[98] If European banks were to be broken up or if their universal banking system was to be abandoned, they would be needlessly squandering one of their strengths. The European countries do not pay great attention to the Volker Rule's restraints on commercial banks' hedge fund and private equity investments because of the insignificant volume of businesses in those areas.[99]

On the other hand, the European Parliament adopted new rules for hedge funds and private equity in November 2010.[100] The directive does not specifically govern banks' hedge funds and private equity-related activities. It generally regulates those industries. Under the new rules, capital and disclosure requirements will be imposed on fund managers across the European Union. Managers will have to comply with such rules as covering, depositary arrangements, and pay and capital distributions. From January 2013, approved fund managers will be allowed to market their funds across the EU with the EU Passport, rather than continue to seek approval on a member country-by-member country basis. The EU Passport may be extended also to fund managers outside the member countries, including those in the United States, from 2015. Put these developments together with the Volcker Rule, and the U.S. banks may be a little

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to control the behavior of major banks. *See* Johnson, *supra* note __, at __.

[96] Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, 2000 J.O. (L 126) 1.

[97] Huw Jones, *Britain Studying High-Frequency Trading Concerns*, REUTERS (Feb. 3, 2010, 6:13 AM EST), http://www.reuters.com/article/2010/02/03/regulation-myners-idUSLDE6120UU20100203? pageNumber=1.

[98] *Id.*

[99] Ronald Orol, *European Delegation Reveals Rift on Volcker Rule, Bank Tax*, MARKETWATCH (June 8, 2010, 7:00 PM EDT), http://www.marketwatch.com/story/european-delegation-reveals-rift-on-volcker-rule-2010-06-08. *Cf.* Eilís Ferran, *Regulation of Private Equity-Backed Leveraged Buyout Activity in Europe* (European Corporate Governance Inst., Law Working Paper No. 84/2007, 2007).

[100] *Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/…/EC*, COM (2009) 207 final (Apr. 30, 2009). *See* Press Release, European Parliament, Parliament Ushers in New EU Rules for Hedge Funds and Private Equity (Nov. 11, 2010).

disadvantaged in the alternative investment sector. The developments and new rules, however, have been criticized as opportunistic as the reform had little real connection to the global financial crisis, simply taking advantage of the inevitable regulatory backlash after the crisis.[101]

B. *A Brief Chronology*[102]

Investment banking in Europe originated in France. French banks were founded as universal banks in the early 1800s. Crédit Mobilier and Union Générale were the examples.[103] However, after Crédit Lyonnais and Société Générale decided to disengage themselves from universal banking,[104] Germany and Switzerland became the places where universal banks grew large.[105] Especially in Germany, investment banking came to play a more important role in financing industrial firms than anywhere else in Europe. Although the capital markets were not well developed in these states, banks remained very close to the industrial firms. Banks owned, supported and controlled the industrial firms.

1. Germany

In 1848, Schaafhausenscher Bankverein was founded in Cologne. It was followed by Deutsche Bank[106] and Commerzbank in 1870, and Dresdner Bank[107] in 1872. These banks were typical of universal banks run in close cooperation of industrial firms.[108] For instance, the family members of Siemens served on the

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[101] *See* Eilís Ferran, *The Regulation of Hedge Funds and Private Equity: A Case Study in the Development of the EU's Regulatory Response to the Financial Crisis* (European Corporate Governance Inst., Law Working Paper No. 176/2011, 2011).

[102] *See* JONATHAN BARRON BASKIN & PAUL J. MIRANTI, JR., A HISTORY OF CORPORATE FINANCE (1997); NIALL FERGUSON, THE CASH NEXUS: MONEY AND POWER IN THE MODERN WORLD, 1700–2000 (2001); CHARLES P. KINDLEBERGER, A FINANCIAL HISTORY OF WESTERN EUROPE (1984).

[103] FLEURIET, *supra* note __, at 7.

[104] FLEURIET, *supra* note __, at 8.

[105] *See* J. Edwards & S. Ogilvie, *Universal Banks and German Industrialization: A Reappraisal*, 49 ECON. HIST. REV. 427 (1996); Caroline Fohlin, *Regulation, Taxation, and the Development of the German Universal Banking System, 1884-1913*, 6 EUR. REV, ECON. HIST. 221 (2002).

[106] For a history of Deutsche Bank, *see* LOTHAR GALL, DIE DEUTSCHE BANK 1870-1995 (1995) (Ger.).

[107] For a history of Dresdner Bank, *see* 1-4 DIE DRESDNER BANK IM DRITTEN REICH (Klaus-Dietmar Henke ed., 2006) (Ger.).

[108] *See* Robert B. H. Hauswald, *On the Origins of Universal Banking: An Analysis of the German Banking Sector 1848 to 1910* (1998) (unpublished manuscript), http://papers.ssrn.com/

board of directors of Deutsche Bank when the bank was established, and Deutsche Bank has remained the house bank (Hausbank) of Siemens even until today.[109]

During the Great Depression in the United States, U.S. banks called in loans made to Europe. The then largest bank in Austria, Creditanstalt, went under in 1931. Creditanstalt was founded by Rothschild in 1855 in Vienna. Panicked by the incident, Germany introduced exchange control after shutting down all banks for two days. German banks were eventually nationalized by Adolf Hitler in 1933.

Deutsche Bank was the largest bank in the world before World War I. After the foundation, it underwrote bonds issued by Krupp, and brought Bayer to the Berlin Stock Exchange. After the War, however, it fell with the Weimar Republic. As Hitler came to power in 1933, Deutsche Bank discharged three Jewish directors and took part in the confiscation of Jewish property. It financed the Nazi's secret police, Gestapo, as well as the construction of the concentration camp in Auschwitz. It became the house bank of IG Farben, Hitler's war machine.[110] After World War II, it was divided into ten local banks and it was not until 1957 when it was reinstated in Frankfurt. Deutsche Bank has been a universal bank since its establishment. But, its character has been a commercial bank largely due to the nature of a bank-centered German economy. From 1989 on, however, Deutsche Bank has been aggressively expanding to the investment banking business along with the quick rise of the capital markets in Germany. In the same year, it acquired Morgan Grenfell and became a serious figure in the world investment banking industry. In 1999, Deutsche Bank acquired Bankers Trust, which acquired Alex Brown in 1997. Alex Brown was founded in 1800 and said to be the oldest investment banking house in the United States. In October 2001, Deutsche Bank was listed on the New York Stock Exchange as the first firm listed after 9/11. Joseph Ackermann, who succeeded Rolf Breuer in May 2002, started an aggressive campaign to change the character of the bank. His appointment to the head position of Deutsche Bank was due to his success in the investment banking operation of the bank. He even considered moving the bank's headquarters to London.[111] Deutsche Bank acquired the Russian UFG (United Financial Group) in 2006.

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sol3/papers.cfm?abstract_id=6696.

[109] FLEURIET, *supra* note __, at 8–9.

[110] IG Farben used to be the fourth largest company in the world after GM, U.S. Steel, and Standard Oil. It was created through the merger of six firms, including BASF, Bayer, Hoechst and Agfa in 1925. *See* DIARMUID JEFFREYS, HELL'S CARTEL: IG FARBEN AND THE MAKING OF HITLER'S WAR MACHINE (2008).

[111] Martin T. Roth, *Abschied von den Königsmachern der Deutschland AG*, FRANKFURTER

Germany has been a bank-centered economy with less-developed capital markets.[112] Therefore, German banks, although being universal banks, have been commercial banks in nature. However, things have changed since the 1980s due to the integration of capital markets from around the world and the economic integration of Europe. German banks have been trying to develop investment banking businesses, Deutsche Bank being the most notable example. The number of mergers and acquisitions amongst banks has also been increasing.[113] German industrial firms have historically been under the practical control of German banks. It was understood as the secret of success and competition of the German economy. The German system was seriously studied by American scholars until at least the 1990s.[114] However, the ownership of industrial firms by the banks was an obstacle for German banks in their strategy to develop investment banking businesses. Through the German banking industry's request, the German government enacted legislation (Steuersenkungsgesetz) in July 2000 to waive capital gains tax for German banks' disposal of shares in industrial firms.[115] One of the strengths of universal banking is that the ownership in industrial firms gives access to corporate information. This, however, became unimportant in the age of mandatory disclosure, financial transparency and digital information[116] while conflicts of interest remained.

ALLGEMEINE ZEITUNG, May 11, 2002, at 15 (Ger.).

[112] Industrial firms finance largely through commercial loans in a bank-centered economy. Loans are extended on a face-to-face basis. In crisis, parties talk, negotiate, and find solutions. On the contrary, in a capital markets-centered economy, parties do not know who the counterparties are. Firms finance through liquid securities and securitizations. In crisis, it is very difficult to find solutions through communications.

[113] *See* Michael Koetter, *Evaluating the German Bank Merger Wave* (Utrecht Sch. of Econ., Working Paper No. 05-16, 2005).

[114] *See, e.g.*, Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J.1927 (1993). One study found that "firm performance improved to the extent that equity control rights are concentrated." And, "bank control rights from equity ownership significantly improved firm performance beyond what nonbank block-holders can achieve." Banks did not extract private value to the detriment of firm performance – German banks did not seek rent. It diagnoses that "perhaps this explains the German success despite of the ownership concentration." Ownership concentration in the hands of financial institutions (not individuals or families) may not be that bad. The U.S. decision for weak banks might have been wrong after all. According to this research, "there was no evidence of conflicts of interest between banks and other shareholders." *See* Gary Gorton & Frank Schmid, *Universal Banking and the Performance of German Firms*, 58 J. FIN. ECON. 29 (2000).

[115] BUS. WK., Nov. 19, 2001, at 31.

[116] Harold James, *Goodbye and Hello to the Universal Bank*, PROJECT SYNDICATE (October 29, 2001), http://www.project-syndicate.org/commentary/james2/English.

2. Switzerland

The banking industry in Switzerland was created in the 14th century in the Geneva area. By the end of the 18th century, Switzerland became one of the international financial power houses of Europe. The neutrality of Switzerland made it possible to avoid involvement in wars and other armed conflicts. Ever since the Vienna Conference of 1815, Switzerland has maintained neutrality. Though it became a member of the United Nations in 2002, Switzerland has not joined the European Union. The neutrality of Switzerland was well preserved even during World War II.[117] Its geopolitical stability attracted capital from around the world.[118] This has been made possible partly because Switzerland maintained strong armed forces.[119] Mark Roe points out that Switzerland's financial markets are unlike those in other civil law jurisdiction as by 1999, Swiss stock market capitalization as a fraction of its GNP exceeded that of the UK and the United States, and Switzerland was not occupied in the 20th century.[120] With no deficits, Switzerland became an exporter of capital. The major importer of Swiss money was French aristocrats and monarchs. This contributed to the development of the Geneva area.[121] When the wave of the industrial revolution reached Switzerland in 1850, big banks emerged in the country to finance the railroads. In the 1890s, power and tourist industries took off, creating more big banks.

When the Glass-Steagall Act was enacted in the United States, Switzerland followed the U.S. model, along with Belgium, Italy and Sweden. Commercial banking and investment banking remained separated until the 1960s in Switzerland.[122] Like German banks, Swiss banks have also been commercial banks in nature,[123] but they have recently been strengthening investment banking activities in order to compete against U.S. financial institutions. Their core

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[117] *Cf.* Detlev F. Vagts, *Switzerland, International Law and World War II*, 91 AM. J. INT'L L. 466 (1997).

[118] *See* INDEP. COMM. OF EMINENT PERS., REPORT ON DORMANT ACCOUNTS OF VICTIMS OF NAZI PERSECUTION IN SWISS BANKS (1999); GREGG J. RICKMAN, SWISS BANKS AND JEWISH SOULS (1999).

[119] Vagts, *supra* note __, at 469.

[120] *See* Mark J. Roe, *Legal Origins, Politics, and Modern Stock Markets*, 120 HARV. L. REV. 460, 509 – 510 (2006).

[121] ANDREAS BUSCH, BANKING REGULATION AND GLOBALIZATION 164–65 (2009).

[122] FLEURIET, *supra* note __, at 14.

[123] Ernst Kilgus, *Universal Banking Abroad: The Case of Switzerland*, in SAUNDERS & WALTER, *supra* note __, at 245.

strategy was to acquire investment banking houses in the United States. Most notably, Credit Suisse acquired First Boston in 1978, and became Credit Suisse First Boston (CSFB). CSFB became Credit Suisse in January 2006. Swiss Bank Corporation (SBC) acquired the British Warburg[124] and U.S. Dillon Read in 1994 and 1997, respectively. SBC merged with Union Bank of Switzerland (UBS) in 1998, and became United Bank of Switzerland (UBS). Warburg and Dillon Read became UBS' investment banking arm. UBS' business is larger in the United States than it is in Switzerland.

C. Developments Since the 2008 Crisis

1. Germany[125]

In Germany, specialized and local banks, not the large national banks, were hit first by the global financial crisis. In 2007, IKB (IKB Deutsche Industriebank) was bailed out by receiving government money in the amount of 1.8 billion Euros and issuing convertible bonds and shares to KfW. KfW ended up owning ninety percent of IKB at the end of the day before it sold IKB shares to Lone Star, the Texas-based private equity firm, for 600 million Euros in October 2008, losing more than eight billion Euros. IKB had invested heavily in structured securities through taking excessive leverage and short-term financing since 2001. Hypo Real Estate Holding (HRE) was next to get into trouble. By the end of 2007, HRE's assets amounted to 400 billion Euros with heavy investments in CDOs related to the U.S. sub-prime mortgage market. HRE's Irish subsidiary, the Irish Depfa Bank, could not continue to refinance its long-term assets. By September of 2008, it became clear that HRE's failure could ruin Germany's whole banking system. A bailout package in the amount of fifty billion Euros was arranged which increased to 100 billion Euros thereafter. It also turned out that the European financial supervisory system had cracks. As an Irish-licensed bank, Depfa was not subject to the direct supervision of BaFin, the German financial supervisory authority. In 2008, WestLB recorded trading losses of 600 million Euros in 2007 and transferred bad assets worth twenty-three billion Euros to a special investment vehicle to remove them from its balance sheet. Again in October 2009, WestLB's troubled assets with a nominal value of seventy-seven billion Euros were transferred into a bad bank for liquidation. HSH Nordbank (HSH) ended up possessing seventeen billion Euros of troubled real estate assets. It received a government guarantee worth thirty billion Euros. Some other Landesbanken followed suit.

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[124] For a history of Warburg, *see* RON CHERNOW, THE WARBURGS (1994).

[125] *See* IBA Report, at 89–116.

Ultimately, the big banks could not avoid the crisis. In January 2009, Commerzbank acquired Dresdner Bank from Allianz for 9.8 billion Euros while the German government provided Commerzbank with 8.2 billion Euros for twenty-five percent plus one share in the bank through the Special Fund for Financial Markets Stabilization (Sonderfond Finanzmarktstabilisierung: SoFFin) which was created by the Financial Markets Stabilization Act (Finanzmarktstabilisierungsgesetz) of 2008 and placed under the administration of a special federal agency Finanzmarktstabilisierungsanstalt (FMSA).[126] SoFFin was equipped with 100 billion Euros cash plus up to 400 billion Euros guarantee issuing authority. The German Stock Corporation Act was partially preempted by the Act on the Acceleration of Financial Market Stabilization (Finanzmarktstabilisierungsbeschleunigungsgesetz) to allow the troubled financial institution to issue new shares to the government without negotiating with the shareholders. The deal was also influenced by the new German restriction on foreign investment.[127] Commerzbank managed to acquire Dresdner Bank even though China Development Bank made a higher bid. However, the merger between Commerzbank and Dresdner Bank led to a lawsuit by the shareholders against their managers.[128]

The universal banking model incorporated in the European Union Credit Institutions Directive of 2000 was heavily influenced by Germany. The trouble, however, is that the German model completely integrates the commercial banking and securities business into one house in such a way that the central bank might become reluctant to play the role of the lender of last resort as far as the securities businesses are concerned. This was what happened in Germany in 2008. The depositors were highly concerned with the insolvency of the banks and therefore started to run on their banks. On October 4, 2008, the German government was forced to offer an unlimited guarantee for all private bank deposits.[129] To convince the depositors that the commercial banking part of the universal bank would not automatically respond to the emergency support from the securities business part, a universal bank must be well equipped with a separation system. It is not an easy task, though. For that reason, German universal banks need to

[126] DOROTHEA SCHÄFER, DEUTSCHES INSTITUT FÜR WIRTSCHAFTSFORSCHUNG [DIW BERLIN], GERMANY'S FINANCIAL CRISIS AND AGENDA FOR A NEW FINANCIAL MARKET ARCHITECTURE (2009).

[127] *See* Franz-Joerg Semler, CMS Hasche Sigle, Investments in Germany: New Restrictions for Foreign Investors (2009).

[128] *Kauf der Dresdner Bank: Commerzbank gewinnt Rechtsstreit mit Aktionären*, FIN. TIMES DEUTSCHLAND, July 12, 2010 (reporting that the judgement of the first instance was reversed by the high court in favor of the bank managers) (Ger.).

[129] Carter Dougherty, *Germany Guarantees Bank Deposits*, N.Y. TIMES, Oct. 5, 2008.

slowly develop the structure of a financial holding or group[130] as the UK banks did.

2. Switzerland[131]

In Switzerland, banks dwarf the rest of the economy. This small country with some eight million people houses more than 200 banks.[132] UBS and Credit Suisse each have assets of more than one trillion Swiss Francs (USD900 billion), twice the size of the Swiss economy.[133] The balance sheet of UBS and Credit Suisse, when combined, is about four times Switzerland's GDP. Switzerland thusly has a severe Too-Big-To-Fail problem.

The global financial crisis of 2008 also hit the Swiss banks hard, with UBS being hit the hardest. UBS wrote off 12.4 billion Swiss Francs in the fourth quarter of 2007 for losses from the subprime mortgage business. The year 2007 was the year UBS recorded its first ever loss. UBS secured eleven billion Swiss Francs from the Government of Singapore Investment Corporation, and another two billion Swiss Francs from anonymous investors. In October 2008, the Central Bank of Switzerland bailed out UBS, investing six billion Swiss Francs to help the bank spin off USD39 billion of toxic assets into a Swiss National Bank fund. The federal state sold its UBS holdings for a profit of 1.2 billion Swiss Francs less than a year later. Credit Suisse also recorded large losses during the same periods.[134] Credit Suisse secured new investments from investors in Qatar, declining government assistance.

A panel appointed by the Swiss government has recently issued recommendations on ways to carve up UBS and Credit Suisse,[135] and Swiss

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[130] Even under the holding or group structure, there may be strong pressure from customers of securities business to pierce the corporate veil. *See* Report from Hwa-Jin Kim & Yong Jae Kim to the Korea Financial Investment Association, The Future of the Business of Investment Banking in Korea 97–107 (2010) (Kor.).

[131] *See* IBA Report, at 117–50; Jürgen Dunsch, *Notoperation für Schweizer Grossbank UBS*, FRANKFURTER ALLGEMEINE ZEITUNG (Jan. 2, 2011), http://www.faz.net/-00xpzz (Ger.); Lukas Hässig, *Arme Schweiz*, DIE ZEIT, Oct. 1, 2008, *available at* http://www.zeit.de/2008/41/Finanzkrise-Schweiz (Ger.).

[132] According to data from 1994, the ratio of those employed in banking to the total number of employed was 3.14% in Switzerland, compared to 2.07% in Germany, 1.21% in the United States, and 0.64% in Japan. *See* BUSCH, *supra* note __, at 164.

[133] SWISS BANKERS ASS'N, http://www.swissbanking.org (last visited Feb. 25, 2011).

[134] BUSCH, *supra* note __, at 248.

[135] Anita Greil, *Switzerland Tightens Bank-Capital Rules*, WALL ST. J., Nov. 11, 2010, *available at* http://online.wsj.com/article/SB10001424052748703805004575606081308850798.

parliament has been discussing the implementation of those recommendations. The banks are required to draw up plans to separate units that are important for the country from businesses that would be allowed to fail in a crisis. Swiss regulators also gave UBS and Credit Suisse four years to raise their risk-weighted capital to as much as double the Basel II requirements. The Swiss regulators are seeking more power to break the two giants up before they collapse.[136] Should another crisis erupt, the government will allow the banks to fail. However, the panel will not further consider banning proprietary trading and has dropped proposals to break up the lenders.[137] Thus far, the Volcker Rule has not found support in Switzerland.[138]

3. A Note on the United Kingdom[139]

During the financial crisis, the UK government bailed out banks with a combined balance sheet of more than two times the UK GDP, which was around USD2.7 trillion at the end of 2008.[140] As a result, the UK government now owns some eighty-three percent of the Royal Bank of Scotland Group, 100 percent of Northern Rock, etc.[141]

There is opinion in the UK that favors functional separation of financial services architecture. It emphasizes "narrow banking," *i.e.*, tight restriction of the scope and activities of commercial banks.[142] It has also been reported that the UK

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[136] UBS website summarizes the virtue of universal banking as follows: "The legal entity group structure of UBS is designed to support the Group's businesses within an efficient legal, tax, regulatory and funding framework. Neither the business divisions of UBS (namely Investment Bank, Wealth Management Americas, Wealth Management & Swiss Bank and Global Asset Management) nor Corporate Center are replicated in their own individual legal entities, but rather they generally operate out of UBS AG (Parent Bank) through its Swiss and foreign branches."

[137] Elena Logutenkova & Dylan Griffiths, *Swiss Too-Big-to-Fail Banking Rules Seek to Avert Icelandic Ending for UBS*, BLOOMBERG (May 5, 2010, 6:01 PM ET), http://www.bloomberg.com/news/2010-05-05/swiss-too-big-to-fail-banking-rules-seek-to-avert-icelandic-ending-for-ubs.html.

[138] *See id.*

[139] *See* IBA Report, at 55–88.

[140] Conference Presentation Materials, Charles Randell, UK Banking After the Crisis, Dodd-Frank and Other International Developments Affecting the Global Financial System After the Crisis 3 (Oct. 27, 2010).

[141] Six banks account for around eighty-eight percent of retail deposits in the UK. *Id*. at 5.

[142] *See* John Kay, *Should We Have 'Narrow Banking'?*, *in* THE FUTURE OF FINANCE: THE LSE REPORT 208 (2010) (also arguing that "regulatory reform should emphasize systemic resilience and robustness, not more detailed behavioural prescriptions.).

considers separating commercial banking and investment banking[143] although it is not certain if such a plan could be implemented. The Independent Commission on Banking, created on June 16, 2010 to consider structural and related non-structural reforms to the UK banking sector, has been looking at separation of retail and investment banking, limits on proprietary trading and investing, and measures to reduce market concentration.[144] John Vickers, Chairman of the Commission, recently ruled out ideas for narrow banking. But he explored the idea that universal banks might be required to ring-fence certain riskier operations from their consumer businesses. According to him universal banking had the disadvantage that unsuccessful investment banking may bring down the whole bank, including the commercial banking arm. Although he indicated that the riskier operations of banks could be required to hold more capital rather than being split off from the bank completely, he rejected the characterization of investment banking operations as "casinos."[145]

As mentioned before, the British system has traditionally been characterized by independent developments of each financial services sector. This was so even though the UK did not have any regulation on the delimitation of financial services. However, the so-called Big Bang of 1987 stimulated the creation of universal banks in the United Kingdom. As the UK universal banks adopted the subsidiaries model, not the in-house model, the Bank of England did not see large contagion risk involved in the universal banking system.[146] Also, the Financial Services and Markets Act of 2000 introduced sophisticated Chinese wall requirements to regulate the conflicts of interest within the financial group.[147]

D. Exkurs: East Asia

Japan requires the separation of commercial and investment banks as the U.S. occupation authority put the U.S. system in place in Japan after World War II.[148] However, the Japanese commercial banks have been engaged in securities

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[143] *See* SCOTT, *supra* note __, at 108.

[144] Randell, *supra* note __, at 7.

[145] *See* John Vickers, How to Regulate the Capital and Corporate Structures of Banks? (Keynote speech given on 22 January 2011 at the London Business School and University of Chicago Booth School of Business conference on *Regulating Financial Intermediaries - Challenges and Constraints*).

[146] *See* Kim & Kim, *supra* note __, at 110–21.

[147] *See* CHARLES HOLLANDER & SIMON SALZEDO, CONFLICTS OF INTEREST & CHINESE WALLS (2nd ed. 2004).

[148] BENSTON, *supra* note __, at 2.

underwriting since 1993.[149] It is reported that Japanese commercial bank's securities underwriting benefits the issuer.[150] Japanese commercial banks are also permitted to trade commercial papers. China requires segregation, too.[151] Commercial bank deposits are the largest financial assets in China and its weight is relatively heavier than that of other countries. As far as the investment banking business is concerned, global houses like Goldman Sachs and Morgan Stanley currently dominate the Chinese market. The global investment banking houses lead the privatization of State-Owned Chinese firms, investing in Chinese commercial banks at the same time.[152] Thus far, Japan and China have not shown great interest in the regulatory developments in the United States, including the Volcker-Rule.

Korea has a plan for moving toward the universal banking system. The Korean government also has plans for the so-called 'megabank' that can be created through mega mergers amongst top commercial banks. The whole idea is that Korean banks are 'too small to succeed' in the global market.[153] As the initial step for moving forward, the Capital Market Integration Act (former Securities and Exchange Act) was enacted and went into force on February 4, 2009. This law consolidated five different laws into one body and now regulates securities, futures and asset management industries. The U.S. style investment banks have been introduced with the designation 'financial investment company.' Even though Korea requires segregation, commercial banks in Korea have been expanding into asset management and mergers and acquisitions businesses. They do investment banking activities through subsidiaries for now. However,

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[149] *See* Jun-Koo Kang & Wei-Lin Liu, *Is Universal Banking Justified? Evidence from Bank Underwriting of Corporate Bonds in Japan* (Dec. 2003) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=641822.

[150] *See* Ayako Yasuda, *Bank Relationships and Underwriter Competition: Evidence from Japan*, 86 J. FIN. ECON. 369 (2007).

[151] For capital markets in China, *see* K. THOMAS LIAW, INVESTMENT BANKING AND INVESTMENT OPPORTUNITIES IN CHINA (2007); David Eu, *Financial Reforms and Corporate Governance in China*, 34 COLUM. J. TRANSNA'L L. 469 (1996); Li Guo, *The Chinese Financial Conglomerate and Its Company Law Implications*, 7 J. KOREAN L. 197 (2007); Benjamin L. Liebman & Curtis J. Milhaupt, *Reputational Sanctions in China's Securities Market*, 108 COLUM. L. REV. 929 (2008); Hui Huang, *Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis*, 10 J. CORP. L. STUD. 219 (2010); CARL E. WALTER & FRASER J. T. HOWIE, PRIVATIZING CHINA: INSIDE CHINA'S STOCK MARKETS (2006); CARL E. WALTER & FRASER J. T. HOWIE, RED CAPITALISM: THE FRAGILE FINANCIAL Foundation of China's Extraordinary Rise (2011).

[152] *See* FLEURIET, *supra* note __, at 78–83.

[153] *See* Kim Hwa-Jin, *supra* note __ [*The Financial Services Industry in the Global Financial Crisis: History and Strategies*].

investment banking business backed by and/or combined with commercial bank's infrastructure and strong capital base remains as Korean commercial bank CEOs' ambition. Being defensive, the financial investment industry in Korea keeps growing. Even after the failed attempt to take over Lehman Brothers in 2008,[154] the Korea Development Bank dreams to become one of the leading investment banks in East Asia. The regulatory developments in the United States, including the Volcker-Rule, have received much attention in Korea.[155]

IV. CORPORATE GOVERNANCE OF UNIVERSAL BANKS

After the financial crisis, bank corporate governance has become a hot issue. In particular, risk management and bank managers' pay are the focus of discussion.[156] The corporate governance of banks is not directly related to the business structure of universal banks. However, the size and complexity of a financial institution may have impact on its corporate governance and vice versa. As seen above, the European countries basically want to keep the conventional universal banking system although they did witness problems inherent to the large and complex financial institutions. This would make corporate governance of universal banks a more significant issue than it was before. If they do not want to adopt the structural approach, prudential rule and corporate governance would be the alternatives.

Since the 1990s, the corporate governance and finance scholarships have produced much about legal origin and corporate governance.[157] There is also discussion on the relationship between legal origin and banking systems.[158] The

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[154] *See Korean Bank in Talks with Lehman Brothers*, N.Y. TIMES, Sept. 2, 2008, *available at* http://www.nytimes.com/2008/09/02/business/worldbusiness/02iht-kdb.15817700.html. SORKIN, *supra* note __, at 212 – 216.

[155] *See The Dodd-Frank Act and Its Impacts on Korea* (Korean language material jointly prepared by the three major financial research institutes in Korea: Korea Institute of Finance, Korea Capital Market Institute and Korea Insurance Research Institute, March 11, 2011).

[156] *See, e.g.*, Commission Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies COM (2010) 284 final (June 2, 2010).

[157] *See, e.g.*, Roe, *supra* note __; Holger Spamann, *The "Antidirector Rights Index" Revisited*, 23 REV. FIN. STUD. 467 (2009); Rafael La Porta et al. (LLS&V), *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000); LLS&V, *Law and Finance*, 106 J. POLITICAL ECON. 1113 (1998).

[158] *See* Coffee, *supra* note __ (*The Rise of Dispersed Ownership)*; Caroline Fohlin, *Does Civil Law Tradition and Universal Banking Crowd Out Securities Markets?: Pre-World War I Germany as Counter-Example*, 8 ENTERPRISE & SOC'Y 602 (2007); Brian R. Cheffins, *Investor Sentiment and Antitrust Law as Determinants of Corporate Ownership Structure: The Great Merger Wave of 1897 to 1903* (Dec. 2002) (unpublished manuscript), http://ssrn.com/abstract=348480.

discussions below, however, focus on the corporate governance of banks, not the banks' role in corporate governance. Despite its importance, research on the corporate governance of banks and bank directors' liabilities has been relatively rare.[159] The global financial crisis has stimulated discussions on bank corporate governance in the United States as well as in Europe.[160]

A. Risk Management

1. Director's Fiduciary Duty to Manage Risks

Many claim that one of the causes of the global financial crisis is the poor corporate governance of banks and other financial institutions.[161] Bank managers were not prudent and the board of directors of banks did not prevent risky lending practices.[162] Banks' internal control system did not function properly. Bank managers' risk appetite was too big, and they regularly ignored risk officers' warnings, with Goldman Sachs and BNP Paribas[163] being exceptions. Part of the bank managers' aggressive attitude to risks can be attributed to their compensation system.[164] One study, after looking at 306 financial institutions in

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[159] For a discussion on the corporate governance of banks using data from 740 banks in 41 countries to evaluate the independence of outside directors, *see generally* Daniel Ferreira et al., *Boards of Banks* (European Corporate Governance Inst., Finance Working Paper No. 289/2010, 2010). *See generally* Pablo de Andres & Eleuterio Vallelado, *Corporate Governance in Banking: The Role of the Board of Directors*, 32 J. BANKING & FIN. 2570 (2008); Olubunmi Faleye & Karthik Krishnan, *Risky Lending: Does Bank Corporate Governance Matter?* (23rd Australasian Fin. & Banking Conference 2010 Paper, 2010); James Fanto, *Paternalistic Regulation of Public Company Management: Lessons from Bank Regulation* (Brooklyn Law Sch. Legal Studies, Working Paper No. 49, 2006); Hanna Westman, *The Role of Ownership Structure and Regulatory Environment in Bank Corporate Governance* (Jan. 14, 2010) (unpublished manuscript), http://ssrn.com/abstract=1435041; BENTON E. GUP ED., CORPORATE GOVERNANCE IN BANKING: A GLOBAL PERSPECTIVE (2007).

[160] For recent research, *see The Governance and Regulation of Financial Institutions: Lessons from the* Crisis, 8 RES. NEWSL. (European Corporate Governance Inst., Brussels, Belg.), Summer 2010; *Corporate Governance and the New Financial Regulation: Complements or Substitutes?*, 9 RES. NEWSL. (European Corporate Governance Inst., Brussels, Belg.), Spring 2011.

[161] *But see* Brian R. Cheffins, *Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Case of the S&P 500*, 65 BUS. LAW. 1 (2009).

[162] *See* Taylor, *supra* note __.

[163] *See* Nicholas Calcina Howson, Commentary, *When "Good" Corporate Governance Makes "Bad" (Financial) Firms: The Global Crisis and the Limits of Private Law*, 108 MICH. L. REV. FIRST IMPRESSIONS 44, 48 (2009), http://www.michiganlawreview.org/assets/fi/108/howson.pdf.

[164] For the relationship between bank performance and corporate governance during the financial crises, *see* Andrea Beltratti & Rene M. Stulz, WHY DID SOME BANKS PERFORM BETTER DURING THE CREDIT CRISIS? A CROSS-COUNTRY STUDY OF THE IMPACT OF GOVERNANCE AND

31 countries, concludes that the higher the ownership of institutional investors and the ratios of bonuses in CEO compensation package, the higher was the tendency of risk taking.[165]

Banks are at the risk center.[166] A bank's business centers on taking risks.[167] The board of directors of banks determines the risk tolerance and the risk appetite of the bank, and develops business strategies based on that decision. Therefore, risk management is at the core of a bank manager's duty.[168] The severity of the 2008 financial crisis was very much about how big banks' managers acquired and mismanaged huge risks[169] and in the process damaged the rest of the financial market and industry, and the broader economy.[170] Banks should construct corporate governance in a way that could maximize the value of the bank as a business organization and, at the same time, minimize the systemic risk.[171] If banks' managers took on excessive risk, they may have benefited the shareholders short-term, but harmed the shareholders in the long run through having externalized the costs to the system.[172] One study even argues that boards

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REGULATION (European Corporate Governance Inst., Working Paper No. 254/2009, 2009). For the corporate governance implications of the Dodd-Frank Act, *see Stephen M. Bainbridge, Quack Federal Corporate Governance Round II* (UCLA Sch. of Law, Law-Econ. Research Paper No. 10-12, 2010).

[165] David Erkens et al., *Corporate Governance in the 2007-2008 Financial Crisis: Evidence from Financial Institutions Worldwide* (European Corporate Governance Inst., Working Paper No. 249/2009, 2009).

[166] PHILIP WOOD, LAW AND PRACTICE OF INTERNATIONAL FINANCE 333–34 (2008).

[167] COMPTROLLER OF THE CURRENCY, THE DIRECTOR'S BOOK: THE ROLE OF A NATIONAL BANK DIRECTOR 10–15 (1997); JAMES W. KOLARI & BENTON E. GUP, COMMERCIAL BANKING: THE MANAGEMENT OF RISK (3rd ed. 2005); HANNA WESTMAN, CORPORATE GOVERNANCE IN EUROPEAN BANKS: ESSAYS ON BANK OWNERSHIP 5 (2009); Jonathan R. Macey & Geoffrey P. Miller, *Bank Failures, Risk Monitoring, and the Market for Bank Control*, 88 COLUM. L. REV. 1153 (1988).

[168] Martin Lipton et al., Wachtell, Lipton, Rosen & Katz, Risk Management and the Board of Directors (2008).

[169] Stephen M. Bainbridge, *Caremark and Enterprise Risk Management*, 34 J. CORP. L. 967 (2009).

[170] Letter from Simon Johnson to Members of the Financial Stability Oversight Council, *supra* note __.

[171] *See generally* George G. Kaufman, *Bank Failures, Systemic Risk, and Bank Regulation*, 16 CATO J. 17 (1996); Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193 (2008). For discussions on Germany, see Daniel Zimmer & Florian Fuchs, *Die Bank in Krise und Insolvenz: Ansätze zur Minderung des systemischen Risikos*, 39 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 597 (2010) (Ger.).

[172] *See* 9 RES. NEWSL. (European Corporate Governance Inst.), *supra* note __, at 1.

of directors of banks were not supposed to minimize the agency costs, but serve a public purpose such as stabilizing financial markets and politics.[173] John Coffee is skeptical about empowering bank shareholders because the shareholders' incentives might be to take greater risk through increasing bank's leverage.[174] The European Commission's Green Paper of June 2, 2010 questions whether shareholder control of financial institutions is still realistic.[175] At this point, the entire discussion on the stakeholder model and sustainability comes back to life.[176]

2. Germany and Switzerland

In 1998, Germany amended the Stock Corporation Act (Aktiengesetz) to introduce the director's duty to manage enterprise risk.[177] Article 91, Section 2 of the Aktiengesetz provides that the management board shall take suitable measures, in particular surveillance measures, to ensure that developments threatening the continuation of the company are detected early.[178] Also, Section 4.1.4 of the German Corporate Governance Code stipulates that the management board of listed companies ensures appropriate risk management and risk controlling in the

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[173] *See* J. R. Booth et al., *Boards of Directors, Ownership, and Regulation*, 26 J. BANKING & FIN. 1973 (2002).

[174] *See* 9 RES. NEWSL. (European Corporate Governance Inst.), *supra* note __, at 5 – 6 ("[T]he more shareholder-friendly the corporate governance regime is at a financial institution, the more that financial institution will ride the rollercoaster of having high earnings in the boom years, and falling earnings and near-bankruptcy in the down years").

[175] *See* John Armour & Wolf-Georg Ringe, *European Company Law 1999-2010: Renaissance and Crisis* 39 – 41 (ECGI - Law Working Paper No. 175/2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1691688.

[176] *See, e.g.*, Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439 (2001); Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L L. J. 129 (2009).

[177] One study finds that the German supervisory board's (in-)competence in finance was related to losses in the financial crisis. *See* Harald Hau & Marcel P. Thum, *Subprime Crisis and Board (In-)Competence: Private vs. Public Banks in Germany* (CESifo, Working Paper No. 2640, 2009).

[178] The original language of the article is as follows: "Der Vorstand hat geeignete Massnahmen zu treffen, insbesondere ein Überwachungssystem einzurichten, damit den Fortbestand der Gesellschaft gefährdende Entwicklungen früh erkannt werden." It may therefore be argued that the article only refers to "Entwicklungen" (developments), not "Risiken" (risks). However, there seems to be no difficulty in interpreting the article to duly recognize a director's duty to manage risk. *See* THEODOR BAUMS, HOUSE OF FIN. GOETHE-UNIVERSITÄT FRANKFURT, RISIKO UND RISIKOSTEUERUNG IM AKTIENECHT (2010) (Ger.).

enterprise.[179] Article 25a, Section 1 of the German Banking Act (Gesetz über das Kreditwesen - KWG) provides that an institution bank must have in place suitable arrangements for managing, monitoring and controlling risks and appropriate arrangements by means of which the institution's financial situation can be gauged with sufficient accuracy at all times. It also provides that an institution must have a proper business organization, an appropriate internal control system, and adequate security precautions for the deployment of electronic data processing.[180] Recently, the German Law on Modernization of Corporate Accounting (BilMoG) has introduced the concept of risk management into the German Commercial Code (Handelsgesetzbuch – HGB) and Aktiengesetz.[181] It remains to be seen how the regulatory developments will lead to better risk management in German universal banks.

It is interesting to see that the BaFin developed special rules for financial services firms that link the compensation issue to risk management. In August 2009, it published an updated version of the Minimum Requirements for Risk Management (Mindestanforderungen an das Risikomanagement). The rule requires financial institutions to maintain an appropriate risk management system pursuant to Paragraph 25 of the KWG, and then Section 71 of the rule addresses the parameters of incentive systems for bank staff. According to that, incentive systems must be harmonized with the general strategic targets of the bank. In particular, compensation systems must be designed so as not to encourage bank managers to take inappropriate levels of risks. Back office people, in particular those involved in risk control, have to also be compensated in a way that appropriately reflects their responsibilities.[182]

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[179] HENRIK-MICHAEL RINGLEB ET AL., KOMMENTAR ZUM DEUTSCHEN CORPORATE GOVERNANCE KODEX 179–85 (3rd ed., 2008) (Ger.).

[180] AKTIENGESETZ KOMMENTAR 1032–39 (KARSTEN SCHMIDT & MARCUS LUTTER EDS., 2008) (Ger.); HANDBUCH DES VORSTANDSRECHTS § 19 (HOLGER FLEISCHER ED., 2006) (Ger.); WERNER PAUKER, UNTERNEHMEN – RISIKO – HAFTUNG: DIE FUNKTION DER GESCHÄFTSLEITERHAFTUNG VOR DEM HINTERGRUND DER STEUERUNG UND VERTEILUNG UNTERNEHMERISCHE RISIKEN (2008) (Ger.).

[181] Michael Kort, *Risikomanagement nach dem Bilanzrechtsmodernisierungsgesetz*, 39 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 440 (2010) (Ger.). For the concept of 'risk' under German law, *see* SCHMIDT & LUTTER, *supra* note __, at 1036 and Jochen Pampel & Dietmar Glage, *Unternehmensrisiken und Risiko-management*, *in* CORPORATE COMPLIANCE: HANDBUCH DER HAFTUNGSVERMEIDUNG IM UNTERNEHMEN 84 (CHRISTOPH E. HAUSCHKA ED., 2007) (Ger.).

[182] For legal rules and discussions regarding remuneration in Switzerland, s*ee* Kunz, *supra* note __, at 113–14 (calling the issue a "political hot potato" in Switzerland).

Swiss law also recognizes the directors' duty to carry out risk assessment and risk management. They are obliged to define the company's risk appetite and tolerance and monitor possible risks. A director's duty to manage risks was introduced in Article 663b of the Swiss Code of Obligations in 2008 although scholars regarded such a duty as given under Article 716a, Paragraph 1 of the Code.[183] The Swiss Code of Best Practice for Corporate Governance of 2002, as amended, effective January 1, 2008, encourages listed companies and economically significant private companies in Switzerland to set up audit committees for risk management.

3. Bank Directors' Liability

The German IKB's former CEO currently stands trial for having misled shareholders and having breached fiduciary duties. He has been accused of not having properly managed risks involved in new financial products and economic developments. It is expected that the legal controversy over the scope of the business judgment rule will take place in terms of the management of the financial institution.[184] Germany formally introduced the business judgment rule in Article 93, Paragraph 1 of Aktiengesetz in 2005.[185]

A bank director can sign a risky contract with a third party on behalf of the bank by considering the interests of the firm. In such a case, whether it should be deemed as the director's neglect of duty towards the corporation is not easy to answer at a glance. That is because it may be viewed as a breach of neither laws and regulations nor the articles of incorporation. Nevertheless, signing a risky contract may expose the corporation to the possibility of insolvency so as to deal a blow in achieving the company's business objectives while affecting the reliance on the company placed by its interested parties such as its shareholders, officers and employees. From the perspective that a company does not exist solely for the purpose of seeking the financial interests of its shareholders, but is a social being that should be sustainable,[186] such an act of a director may cause harm to the

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[183] *See* Peter V. Kunz, *Swiss Corporate Governance–an Overview*, *in* SWISS REPORTS PRESENTED AT THE XVIIITH INTERNATIONAL CONGRESS OF COMPARATIVE LAW 99, 111–12 (2010).

[184] *See* IBA Report, at 93.

[185] *Cf.* ANDREA LOHSE, UNTERNEHMERISCHES ERMESSEN (2005) (Ger.). Article 754 of Swiss Code of Obligations stipulates directors' duties and liabilities. Although the business judgment rule has not been formally introduced in Switzerland yet, Swiss directors can be insulated from liabilities by fulfilling similar requirements as those for the application of the business judgment rule in the United States and Germany.

[186] *Cf.* ANDRES R. EDWARDS, THE SUSTAINABILITY REVOLUTION: PORTRAIT OF A PARADIGM SHIFT (2005); CHRIS LASZLO, THE SUSTAINABLE COMPANY: HOW TO CREATE LASTING VALUE THROUGH SOCIAL AND ENVIRONMENTAL PERFORMANCE (2003).

company as well as to all of its interested parties even though it is in the short-term interest of shareholders. As banks create systemic risks, the sustainability consideration is more compelling to bank directors.[187]

The level of a director's fiduciary duty owed to the corporation very much depends upon the size and business area of the corporation. The rule can be best understood in terms of bank director liability. Banks are required to contribute to the stability of the financial markets and to the development of the national economy. Therefore, for instance, the Korean Supreme Court once ruled that bank directors must fulfill their fiduciary duties with utmost (enhanced) care.[188] Swiss law also recognizes higher levels of duty owed by the directors' of financial institutions.[189] The conventional protection provided by the business judgment rule may be weaker for bank directors. Such fiduciary duties include the duty to properly manage risks as discussed above. By violating the duty to manage risks, bank director can be held liable to the bank and/or shareholders, depending upon the jurisdiction.[190] The bank director may breach the fiduciary duty to the bank even when the director acted in the short-term interest of the bank if the act exposed the bank to higher enterprise risk and caused the bank to be responsible for the increase of systemic risk.[191]

B. Bankers' Pay

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[187] For a bank manager's obligations under the various laws in the United States, *see* COMPTROLLER OF THE CURRENCY, DUTIES AND RESPONSIBILITIES OF DIRECTORS (SECTION 501) (1998).

[188] *See* Hwa-Jin Kim, *Directors' Duties and Liabilities in Corporate Control and Restructuring Transactions: Recent Developments in Korea*, 2006 Oxford U. COMP. L. F. 2.

[189] *See* Kunz, *supra* note __, at 132.

[190] Under Article 401 of the Korean Commercial Code, a director may be held jointly and severally liable to third parties for any damages incurred by such third parties resulting in the failure of such director to perform his or her duties, either willfully or by gross negligence. This provision is unique in that it holds directors liable to third parties for breach of their fiduciary duties owed to their own corporation. Third parties regularly incur losses due to corporation's breach of their contract. Therefore, it is puzzling and hard to understand why directors who decided to breach a third-party contract for the benefit their corporation and shareholders got held liable to third parties. The Korean Supreme Court and other Korean courts have had a difficult line-drawing problem and had to identify the circumstances where breach of a third-party contract done for the benefit of the company constitutes director's breach of fiduciary duty to the company. *See* Kim, *supra* note __ [*Corporate Governance of Banks and Bank Director Liability*].

[191] *See In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106 (Del. Ch. 2009); Robert T. Miller, *The Board's Duty to Monitor Risk after Citigroup*, 12 U. PA. J. BUS. L. 1153 (2010).

How to regulate the bankers' compensation has been a hot issue since the outbreak of the financial crisis. It is now well known that compensation arrangements in the investment banking industry arguably[192] motivated excessive risk taking.[193] The problem is, however, that no matter how the bonus arrangements were made, it was not to serve the shareholders' interest. Most pay and bonus arrangements were linked to the actual performance of bank managers.[194] Therefore, private ordering may not solve the problem satisfactorily. Rather, government's direct intervention will do the job. The Dodd-Frank Act addresses the issue by requiring shareholders' non-binding resolution for CEO compensation and the golden parachute ('say on pay')[195] modeled after the UK's shareholder advisory vote on directors' compensation. The SEC has the authority to waive the requirement. Firms are required to set up a compensation committee with independent directors for that matter. Financial institutions with assets in excess of one billion dollars shall disclose compensation arrangement including performance-linked bonuses.

European countries have also introduced the regulation on bankers' pay by promulgating guidelines. Under huge political pressure, banks in the UK, Germany and France moved to limit bonuses in 2009. In 2010, the European Union enacted legislation to force European banks to curb excessive pay to bankers.[196] Bankers in the European Union will be barred from taking more than

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[192] *See* 9 RES. NEWSL. (European Corporate Governance Inst.), *supra* note __, at 5 (summarizing John Coffee's assertion that Dodd-Frank was premised on the still debatable assumption that flaws in executive compensation formulas were responsible in significant part for the crisis).

[193] *See* Lucian A. Bebchuk et al., *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman* 2000–2008 (Harvard John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 657, 2010).

[194] Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247 (2009); Written Testimony Submitted by Professor Lucian A. Bebchuk, William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance and Director of the Corporate Governance Program at Harvard Law School, Before the Committee on Financial Services, United States House of Representatives, Hearing on Compensation Structure and Systemic Risk (June 11, 2009), *available at* http://www.law.harvard.edu/faculty/bebchuk/Policy/FSC-written-testimony-June-11-09.pdf.

[195] Title IX, Subtitle E. Dodd-Frank's say on pay became effective in January 2011.

[196] European Parliament Legislative Resolution of 7 July 2010 on the Proposal for a Directive of the European Parliament and of the Council Amending Directives 2006/48/EC and 2006/49/EC As Regards Capital Requirements for the Trading Book and for Re-Securitisations, and the Supervisory Review of Remuneration Policies, EUR. PARL. DOC. P7_TA(2010)0274 (2010). *Cf.* Remuneration of Directors of Listed Companies and Remuneration Policies in the Financial Services Sector, Eur. Parl. Doc. INI/2010/2009 (2010). For the critical comments, *see* Guido Ferrarini et al., *Executive Remuneration in Crisis: A Critical Assessment of Reforms in Europe*, 10

thirty percent of their bonus in cash starting in 2011, and risk losing some of the remainder should the bank's performance erode. Banks that do not fully comply with the rule will have to set aside more capital to make up for the risk. If national regulators determine that a bank's compensation structure encourages risk, they can force the bank to place hundreds of millions of Euros more in its capital cushion as insurance. Banks that received government bailout funds would also have to justify the compensation of their managers to the governments.[197] Switzerland, not a member of the European Union, has also introduced limits on banker's pay.[198]

In the UK, the Financial Services Authority issued the final form of the revised Remuneration Code on December 17, 2010. The Code introduces significant restrictions on the way in which remuneration policies and structures are operated within financial institutions in the UK and beyond.[199] The Code builds upon international standards set by the Financial Stability Board at a European level and goes beyond those standards in a number of key respects.[200] The Code, among others, subscribes to the principle of proportionality.

Germany enacted the Law on the Appropriateness of Board Member Compensation (Gesetz zur Angemessenheit der Vorstandsvergütung – VorstAG). Under the VorstAG, the total compensation for executives must reflect both the duties and responsibilities owed by them as well as the overall financial situation of the company. The compensation contract must allow the downsizing of the compensation package in case the financial situation of the company deteriorates. The supervisory board members may be held liable if they determined an inappropriate compensation package for an executive. The annual general shareholders' meeting is entitled to approve the compensation package.

J. CORP. L. STUD. 73 (2010).

[197] Liz Alderman, *Cap on Bank Bonuses Clears Hurdle in Europe*, N.Y. TIMES, July 7, 2010, *available at* http://www.nytimes.com/2010/07/08/business/global/08bonus.html; *Regierung will gegen Boni vorgehen*, FAZ.net, Oct. 1, 2010, *available at* http://www.faz.net/s/RubD16E1F55D21144C4AE3F9DDF52B6E1D9/Doc~E5FA9A1CB36C248039D7BADA76C5FA759~ATpl~Ecommon~Scontent.html.

[198] *See* Adam C. Pritchard, *Populist Retribution and International Competition in Financial Services Regulation* 24–25 (Univ. of Mich. Law Sch. Empirical Legal Studies Ctr., Working Paper No. 10-004, 2010).

[199] *See* SHEARMAN & STERLING LLP, THE UK'S FINANCIAL SERVICES AUTHORITY ISSUES THE FINAL-FORM REMUNERATION CODE 1 (2010).

[200] *Id.*

Executive compensation, including bankers' pay, has been a big issue also in Switzerland.[201] Upon a citizen's initiative (the "Abzocker-Initiative"), there is going to be a national vote on the amendment of Swiss Federal Constitution.[202] The initiative covers a lot of ground, including proposal against rip-off salaries. It may not be understood as being designed solely for shareholder value, but it may also target some social goals.[203] The text of the initiative actually states that it was made "[t]o protect the economy, private property and the shareholders and in the spirit of sustainable corporate management."[204] Amongst top Swiss banks, Credit Suisse seems to lead taking move on bonuses,[205] whereas the UBS rather balks.[206]

C. The Role of the State in the Corporate Governance of Banks

Government is neither the owner of big businesses nor their financier. However, government involvement in the corporate governance of private companies has been increasing recently for various reasons.[207] The failure of any of a few very large corporations, including financial institutions, can take down a big part of the economic system. It may also have adverse impacts on the job markets which are politically sensitive. Government arranges acquisitions,

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[201] For legal rules and discussions regarding remuneration in Switzerland, s*ee* Kunz, *supra* note __, at 113 – 114 (calling the issue as "political hot potato" in Switzerland). *See Banker-Boni und die Politik*, NEUE ZÜRCHER ZEITUNG, Sept. 4, 2010, *available at*, http://www.nzz.ch/nachrichten/wirtschaft/aktuell/banker-boni_und_die_politik_1.7441425.html.

[202] *Der Lohn endet bei 3 Millionen Franken*, NEUE ZÜRCHER ZEITUNG, Dec. 17, 2010, *available at*, http://www.nzz.ch/nachrichten/politik/schweiz/der_lohn_endet_bei_3_millionen_franken_1.8713070.html.

[203] PRICEWATERHOUSECOOPERS, EXECUTIVE COMPENSATION & CORPORATE GOVERNANCE 14 (2010) (survey examining compensation structure in SMI and SMIM companies as well as say-on-pay).

[204] For the full text of the initiative, *see* Alexander F. Wagner & Christoph Wenk, Say-on-Pay in Switzerland: Binding Say-on-Pay and Its Impact on Shareholder Value (Working Paper, 2010).

[205] *See* Katharina Bart, *Credit Suisse Takes Risky Move on Bonuses*, WALL ST. J., Jan. 10, 2011, *available at*. http://blogs.wsj.com/source/2011/01/10/credit-suisse-takes-risky-move-on-bonuses/?KEYWORDS=Credit+Suisse+Takes+Risky+Move+on+Bonuses.

[206] *See UBS informiert später über Boni*, NEUE ZÜRCHER ZEITUNG, Feb. 4, 2011, *available at*. http://www.nzz.ch/nachrichten/wirtschaft/aktuell/ubs_bonus-zahlungen_1.9351163.html.

[207] *See generally* Jeff Gordon, *The Government as Investor/Owner in the U.S.*, TRANSATLANTIC CORP. GOVERNANCE DIALOGUE (Sept. 2009), http://www.ecgi.org/tcgd/2009/presentations/gordon.pdf; Gerard Hertig, *The Government as Investor/Owner in Europe*, TRANSATLANTIC CORP. GOVERNANCE DIALOGUE (Sept. 2009), http://www.ecgi.de/tcgd/2009/presentations/hertig.pdf.

sometimes providing the bailout funds to facilitate the deal. For strategically crucial companies, government acts as the guardian against foreign capital as was exemplified in the Unocal and Dubai Ports World[208] cases. The concept of national security[209] is being replaced by the concept of systemic importance. The global financial crisis has called some old principles into question. For the first time in its history, the U.S. government holds major ownership stakes in large companies and financial institutions and is playing an increasingly active role in their governance.[210]

The role of government has traditionally been important in the financial services industry. As there are such stakeholders for commercial banks as depositors and deposit insurance institutions, government has reasons to get involved in the corporate governance of commercial banks.[211] In emerging jurisdictions, large banks have mostly been privatized recently. Their government and banks are therefore in the shadow of a still fresh memory of the past. The role of the state has become even more significant after the financial crisis as many large banks in the United States and Europe were bailed out by the governments. Although governments now hold a dominant position in the corporate governance of banks, they are not in the position to effectively manage the banks. Therefore, the status of the governments in the bank corporate governance needs to be determined in a way to assist the financial regulatory reform in the United States as well as in Europe.[212]

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[208] *See* Jason Cox, *Regulation of Foreign Direct Investment After the Dubai Ports Controversy: Has the U.S. Government Finally Figured Out How to Balance Foreign Threats to National Security Without Alienating Foreign Companies?*, 34 J. CORP. L. 293 (2008); Deborah M. Mostaghel, *Dubai Ports World under Exon-Florio: A Threat to National Security or a Tempest in a Seaport?*, 70 ALB. L. REV. 583 (2007).

[209] *See* EDWARD M. GRAHAM & DAVID M. MARCHICK, U.S. NATIONAL SECURITY AND FOREIGN DIRECT INVESTMENT (2006).

[210] *See* Kim Hwa-Jin, *Gi-eop-ui so-yuji-baegujo-wa jeongbu-ui yeoghal* [*Government in Corporate Governance*], 408/409 KOREAN BAR ASS'N J. 60/23 (2010) (Kor.).

[211] *Cf.* Jennifer Carpenter et al., *Reforming Compensation and Corporate Governance*, in: REGULATING WALL STREET: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE 493, 506 – 507 (VIRAL V. ACHARYA ET AL. EDS., 2011).

[212] Marcel Kahan & Edward Rock, *When the Government is the Controlling Shareholder* (Univ. of Penn., Inst. for Law & Econ., Research Paper No. 10-10, 2010) ("Corporate law provides a complex and comprehensive set of standards of conduct to protect noncontrolling shareholders from controlling shareholders who have goals other than maximizing firm value, but are designed with private parties in mind. We show that when the government is the controlling shareholder, the Delaware restrictions are largely displaced, but hardly replaced, by federal provisions. When GM goes public again, government ownership of a controlling position will be a significant 'risk factor.'")

V. A GLOBAL STRUCTURAL REGULATION?

A. Convergence in Financial Regulation

Since the 1980s, national corporate governance systems have been the focus of numerous academic studies. Good corporate governance law and practice were believed to be competitive forces not only for individual firms, but also for national economies. Comparative corporate law studies[213] and convergence theories[214] gained much attention accordingly. Now, it is about time to (re)focus on financial regulatory systems of the world in terms of competition and convergence. As Bernard Black did suggest it for comparative corporate governance studies,[215] many of the core problems of financial regulatory system are universal, and, accordingly, the range of reasonable solutions may be finite. Universal banking and its regulatory issues need to be studied seriously in order to understand the origins of structural differences of financial markets and financial services industries. Comparative financial system and regulation must regain its importance in academia and practice. As Adam Pritchard puts it, regulation on big banks will converge over time, but jurisdictional competition for hedge funds will be one of the most important topics in the future.[216] We need to know whether different structures achieve distinct level of performance and the structural differences are the sole result of different regulatory attitudes.[217]

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[213] *See, e.g.*, Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance*, 74 WASH. U. L. Q. 367 (1996); Brian Cheffins & Bernard Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385 (2006); Katharina Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PA. J. INT'L ECON. L. 791 (2002); MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994); REINIER KRAAKMAN ET AL. EDS., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 2ND ED. (2009); Bernard Black et al., *Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability*, 2008 COLUM. BUS. L. REV. 1; Bernard Black et al., *Legal Liability of Directors and Company Officials Part 1: Substantive Grounds for Liability*, 2007 COLUM. BUS. L. REV. 614.

[214] *See, e.g.*, Hansmann & Kraakman, *supra* note __; RANDALL K. MORCK ED., A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS (2005).

[215] *See* Bernard S. Black et al., *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness*, 26 J. CORP. L. 537, 544 (2001).

[216] *See* Pritchard, *supra* note __ at __.

[217] *See* Alfred Steinherr, *Performance of Universal Banks: Historical Review and Appraisal*, 2 in: SAUNDERS & WALTER, *supra* note __, at 2.

The efficiency and (international) competitiveness of financial institutions are an inherent part of any country's development strategy. Economies of scale and scope are the primary goal of the banking business as it is in other businesses. Big banks and universal banks are an attractive model, including to bank managers, shareholders and employees; but ironically, big banks and universal banks can create systemic risk easier than smaller and specialized banks. It can ruin the entire economy. This is the dilemma most governments face. It is part of the tensions between regulation and competition that can never be resolved once and for all as Davies and Green put it.[218] The solutions are different as the economic and political situations are different, but at the same time, no financial system is isolated from others. Convergence and persistence will be an important topic in this area in the coming years. Comparative financial system study,[219] therefore, may benefit the evolution of international financial regulation.[220]

The Volcker-Rule may set the direction for international guidelines for the structure of doing banking business also outside the United States as the Sarbanes-Oxley Act of 2002 did in international corporate governance.[221] Although governments will differ in opinions in respect of the substance of the Volcker-Rule, they will not have serious problem on agreeing on the core proposition behind the Volcker-Rule that the commercial banking activities of a universal bank should not stray too far from their central mission of serving their customers. Such guidelines may well shape the structure of large international banks' businesses in future. Corporate governance of financial institutions may be a good starting point.[222] As shown above, there is a significant convergence in law and practice of corporate governance (of banks) amongst the United States, Germany and Switzerland. It is not something that was created through European countries' responses or adaptation to the developments in the United States and U.S. system. It has been made possible because the governments agree on such

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[218] HOWARD DAVIES & DAVID GREEN, GLOBAL FINANCIAL REGULATION: THE ESSENTIAL GUIDE 29 (2009)

[219] For a survey, *see* Joseph Haubrich & James B. Thomson, *Comparative Financial Systems: Introduction*, 30 J. MONEY, CREDIT & BANKING 421 (1998) and Franklin Allen & Douglas Gale, *Comparative Financial Systems: A Survey* (Ctr. for Fin. Insts., Working Paper No. 01-15, 2001).

[220] Whether there existed a relationship between regulatory structure and financial stability is a controversial issue. *See* DAVIES & GREEN, *supra* note __, at 205–06. *Cf.* Jiandong Ju & Shang-Jin Wei, *When Is Quality of Financial System a Source of Comparative Advantage?* (Nat'l Bureau of Econ. Research, Working Paper No. 13984, 2008).

[221] *Cf.* Kate Litvak, *Sarbanes-Oxley and the Cross-Listing Premium*, 105 MICH. L. REV. 1857 (2007).

[222] *See* ALEXANDER ET AL., *supra* note __, at 239-50.

basic propositions of corporate governance of banks as risk management, management accountability and transparency.

B. Allocation of Regulatory Authority

To be sure, it is hard to foresee whether a meaningful international regulatory arrangement could be made. It will not be easy to create international rules for the business structure and conduct of financial institutions. Governments have incentives to cooperate with other governments but only to the extent that they achieve their own policy goals. Nevertheless, incentives to cooperate on the global level are far greater than so far due to the severity of the financial crisis, the stage of global integration of financial markets,[223] and the activities of financial institutions. Scholars have emphasized the need for ongoing coordination and cooperation between European and U.S. regulators for the effective supervision of financial conglomerates.[224] National financial systems will converge at least for the time being and an international standard will emerge. International supervision and prudential regulations have been proven to be feasible and work well in practice. John Coffee also predicts international convergence in financial regulation supporting the contingent capital alternative.[225] The future of universal banking and big global financial institutions will be determined by such standards. This may be different than it has been in the corporate governance area where formal convergence has been proven most difficult due to various path-dependence-related factors.[226]

The approach to the issue of the allocation of regulatory authority[227] should not be *de facto* extraterritoriality or forced harmonization, though. Such an

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[223] Stock exchange mergers continue. *See NYSE, Deutsche Börse Talk Tie-Up as Competition Intensifies*, WALL ST. J., (Feb. 10, 2011), http://online.wsj.com/article/SB10001424052748704858404576134153000503870.html. *See also* Roberta S. Karmel, *The Once and Future New York Stock Exchange: The Regulation of Global Exchanges*, 1 BROOK. J. CORP. FIN. & COM. L. 355 (2007).

[224] Kern Alexander, Eilis Ferran, Howell Jackson & Niamh Moloney, *A Report on the Transatlantic Financial Services Regulatory Dialogue* 28 – 31 (Harv. L. & Econ. Discussion Paper No. 576, January 2007), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=961269.

[225] John C. Coffee, Jr., *Bail-Ins versus Bail-Outs: Using Contingent Capital to Mitigate Systemic Risk* (Columbia Law School, Working Paper No. 380/2010, 2010). Contingent capital is a debt security that can automatically be converted into equity to avoid bankruptcy. The Dodd-Frank Act authorizes the Fed to mandate the use of contingent capital. *See* Section 165(b)(1)(B) of the Dodd-Frank Act.

[226] *Cf.* Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329 (2001); Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127 (1999).

[227] For an early discussion on the proper allocation of global regulatory authority, *see*

approach may arguably cause jurisdictional conflicts[228] and a race to the bottom through competition among governmental bodies. The Dodd-Frank Act grants U.S. courts jurisdiction to hear securities actions brought by the SEC or the Justice Department that involve extraterritorial elements.[229] Also, as indicated above, the Dodd-Frank Act could operate along similar lines to the Sarbanes-Oxley Act's effects on international corporate governance. For example, Section 173 of the Dodd-Frank Act stipulates access guidelines to the U.S. financial market by foreign firms. The SEC is authorized to refuse to register foreign brokers that present a risk to the U.S. financial system and have a home country that has not adopted or progressed toward adopting financial regulation to mitigate that risk. David Skeel points to the provision as an attempt to force harmonization of international financial regulation.[230] The speculation is that the provision aims to force other countries to put regulatory structures similar to the Dodd-Frank Act in place, or face with consequences against their own firms.[231] The approach is not productive. The Unites States, and any other state in the world, should not use foreign firms, either listed on its stock exchange or doing business within the state, in its foreign policy enforcement. If the United States wants to achieve harmonization, it should do so through an international forum and/or international rule-making agency. The substance of the Volcker-Rule can be housed in an international rule to be effectively disseminated to outside of the United States.

C. The Role of the Basel Committee

Convergence in the regulation of financial institutions can be achieved through voluntary, not forced, harmonization. The European Union has been successful in harmonizing national standards in capital markets law[232] through

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Howell E. Jackson, *Centralization, Competition, and Privatization in Financial Regulation*, 2 THEORETICAL INQUIRIES IN LAW 649 (2001).

[228] As far as the U.S. securities law is concerned, the U.S. Supreme Court has recently put limits on its extraterritorial reach: Morrison v. National Australia Bank, June 24, 2010, http://www.supremecourt.gov/opinions/09pdf/08-1191.pdf. *See generally* Erez Reuveni, *Extraterritoriality as Standing: A Standing Theory of the Extraterritorial Application of the Securities Laws*, 43 UC DAVIS L. REV. 1071 (2010); Amir Licht, Xi Li & Jordan I. Siegel, *What Makes the Bonding Stick?: A Natural Experiment Involving the Supreme Court and Cross-Listed Firms* (Harv. Bus. School Working Paper 11-072, 2011).

[229] Sections 929P(b), 929Y.

[230] SKEEL, *supra* note __, at 184.

[231] *Id.* Others suggest that this may also be an attempt to reduce regulatory arbitrage. *See* MAYER BROWN, UNDERSTAND THE NEW FINANCIAL REFORM LEGISLATION: THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT 105 (2010).

[232] *See* EILÍS FERRAN, BUILDING AN EU SECURITIES MARKET (2005) (discussing the fundamental issues concerning the legal framework that has been established to support a single

reciprocity and commonality principles.[233] The IOSCO has also been doing excellent works on creating centralized set of minimum standards in the securities regulation. Convergence in bank corporate governance is not the product of forced harmonization and therefore amenable to international rules. Financial regulations should follow suit.

As the Basel Committee on Banking Supervision already has created guidelines for corporate governance of banks,[234] it can also be instrumental in creating the international rules for the structure of banking businesses. The Basel Committee already has excellent track records in making and implementing the prudential rules. Its rules are well complied even by non-member states of the Bank for International Settlements (BIS) due to their nature as soft law.[235] As the Committee itself states, it is "best known for its international standards on capital adequacy; the Core Principles for Effective Banking Supervision; and the Concordat on cross-border banking supervision."[236] The author once suggested that the BIS rules greatly influenced corporate governance of Korean companies through the involvement of the International Monetary Fund in the regulatory reform process in Korea after the Asian financial crisis of 1997.[237] If the Committee promulgates relevant rules for the structure of banking business, the rule may have strong normative power through similar mechanism.[238] Again, if member states are still not ready to accept such an approach, the Committee may expand and strengthen the power of prudential rules and improve the bank corporate governance.

EU securities market).

[233] *See generally* Marc I. Steinberg & Lee E. Michaels, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity*, 20 MICH. J. INT'L L. 207 (1999); Pierre-Hugues Verdier, *Mutual Recognition in International Finance*, 52 HARV. INT'L L. J. 55(2011).

[234] BASEL COMMITTEE ON BANKING SUPERVISION, ENHANCING CORPORATE GOVERNANCE FOR BANKING ORGANISATIONS (1999); BASEL COMMITTEE ON BANKING SUPERVISION, ENHANCING CORPORATE GOVERNANCE FOR BANKING ORGANISATIONS (2006); INTERNATIONAL FINANCE CORPORATION, THE 2006 BCBS GUIDELINES ON ENHANCING THE CORPORATE GOVERNANCE FOR BANKING ORGANIZATIONS (2006).

[235] *See* Daniel E. Ho, *Compliance and International Soft Law: Why Do Countries Implement the Basle Accord?*, 5 J. INT'L ECON. L. 647 (2002); Lawrence L. C. Lee, *The Basle Accords as Soft Law: Strengthening International Banking Supervision*, 39 VA. J. INT'L L. 1 (1998).

[236] *See* http://www.bis.org/bcbs/.

[237] *Cf.* ANDREW SHENG, FROM ASIAN TO GLOBAL FINANCIAL CRISIS (2009).

[238] *See* Hwa-Jin Kim, *Taking International Soft Law Seriously: Its Implications for Global Convergence in Corporate Governance*, 1 J. KOREAN L. 1 (2001).

VI. CONCLUDING REMARKS

This Article reviewed the historical background of the Glass-Steagall Act of 1933 along with the developments in the markets that led to the GLBA. It analyzed the discussions on the Volcker Rule in the Dodd-Frank Act in terms of the reinstatement of the Glass-Steagall Act from a comparative perspective. Many countries developed the plan for moving toward the universal banking system that has been prevalent in Europe and the United States since the enactment of the GLBA. This Article concludes that the developments and discussions in the United States have been shaped largely through politics in the United States then and now. The United States once separated commercial banking and investment banking for political reasons. The separation was abandoned for economic reasons, and partially restored again for largely political reasons. The whole process was uniquely American. To support the argument, this Article looked into the situation in Europe, in particular in Germany and Switzerland; however, this Article generally agrees with the proposition that the commercial banking activities of a universal bank should not stray too far from their central mission of serving their customers, and proposes that international rules for the business structure and conduct of financial institutions including the proposition could be possible. Convergence in bank corporate governance is a good indication for one in financial regulation.

Transatlantic differences in the financial system and structure of banking business can be attributed to political and historical factors. Banks are under the strong influence of the history and politics of their states of origin and places of business, and their strategy is determined by such factors. However, the practices and strategies of financial institutions in the United States and Europe seem to converge toward each other. The U.S. financial institutions have been pursuing the European universal banking model ever since the Glass-Steagall Act was enacted. European universal banks have been expanding into the investment banking business through aggressive acquisitions as well as organic growth. Over time, two sides of the Atlantic may look much alike as far as the structure of banking business is concerned. It seems that the global financial crisis has contributed to the trend. Now it is time for legal reform to follow the developments in practices. To maintain current levels of standards of living, we need to keep financial complexity as it is today[239] and develop the regulatory sophistication by which the global economy could benefit from the financial services on the global scale.

[239] *See* Greenspan, *supra* note __.