

## REGULATION OF CROSS-BORDER SWAPS

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### **I. Introduction**

At a recent Washington roundtable on derivatives regulation, a senior staff member of the European Commission took the unusual step of publicly telling U.S. regulators: “Washington, we have a problem.”<sup>1</sup> The problem is U.S. regulation of cross-border swaps. Specifically, the U.S. Commodity Futures Trading Commission (CFTC) has issued proposed rules that subject any swap between a U.S. person and a non-U.S. person to U.S. swap regulation generally. This presents obvious conflicts with foreign regulation. For example, a cross-border swap cannot be cleared in both a U.S.-registered clearinghouse and separately in a different clearinghouse registered in the European Union (EU). We suggest below an alternative regulatory approach to cross-border swaps: U.S. regulators should consider each transaction-level requirement (including clearing and margin) and propose specific cross-border solutions that recognize both the U.S. policy goals and the potential for conflicts with foreign laws and regulations.

### **II. International Swap Regulation**

#### **A. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)**

The Dodd-Frank Act amended section 2(i) of the Commodity Exchange Act (CEA) and section 30(c) of the Securities Exchange Act of 1934 (Exchange Act) to address jurisdiction over swaps and security-based swaps (SB Swaps).<sup>2</sup> However, the

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<sup>1</sup> Patrick Pearson, Head of Unit, Fin. Mkt. Infrastructure, European Comm’n, Remarks at Global Market Advisory Committee Meeting (Nov. 7, 2012) (transcript available at [http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/gmac\\_110712\\_transcript.pdf](http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/gmac_110712_transcript.pdf)).

<sup>2</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 722, 772, 124 Stat. 1376, 1672–75, 1801–02 (2010).

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provisions do not provide clear guidance as to how the Dodd-Frank Act and related regulation govern derivatives trades between U.S. persons and non-U.S. persons, which we refer to as “cross-border swaps.” Section 2(i) provides that regulation under the Dodd-Frank Act does not apply to swap activity conducted outside the United States, unless that activity has a “direct and significant connection with activities in, or effect on, commerce of the United States.”<sup>3</sup> Similarly, section 30(c) of the Exchange Act provides that regulation adopted under the Dodd-Frank Act does not apply to SB Swaps transactions executed “without the jurisdiction” of the United States unless the activity contravenes other regulation enacted to counter evasion of Dodd-Frank Act provisions.<sup>4</sup> While the language of these amended sections of the CEA and the Exchange Act recognizes that there should be limits on the extraterritorial reach of these statutes, it does not define “outside” or “without” the U.S. or give guidance as to how the relevant statutes should be interpreted in the specific case where a swap trade is between a U.S. person and a non-U.S. person.<sup>5</sup>

### **B. Treatment of Cross-Border Transactions Before the Dodd-Frank Act**

Prior to the adoption of the Dodd-Frank Act, there was no U.S. regulation of swaps. U.S. regulation of similar financial products (such as futures and options) offers helpful insights in fashioning a workable approach to cross-border swaps. For example, the CFTC has adopted rules under the CEA that govern the sale of foreign exchange-traded futures and options to U.S.-based investors.<sup>6</sup> Under section 30.5 of these rules, a non-US broker involved in foreign futures and options transactions with U.S. persons may apply to the CFTC for an exemption from otherwise applicable registration requirements.<sup>7</sup> Similarly, Rule 15a-6 adopted by the Securities Exchange Commission (SEC) provides that foreign broker-dealers engaging in securities transactions with U.S. investors may be exempt from SEC registration if the foreign broker-dealer complies with specified requirements (such as selling only to registered U.S. broker-dealers or banks).<sup>8</sup> These exemptions demonstrate acknowledgement by the CFTC and the SEC that some aspects of cross-border transactions ought not be subject to full U.S. regulation.

Just prior to the enactment of the Dodd-Frank Act, the U.S. Supreme Court ruled on a case regarding the scope of extraterritorial application of U.S. securities regulation. In *Morrison v. National Australia Bank Ltd.*, the Supreme Court held that the anti-fraud provisions of U.S. securities laws do not apply to purchases by non-U.S. investors of securities of a foreign issuer traded on a foreign exchange—despite the investors’ claim

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<sup>3</sup> *Id.* § 722(d).

<sup>4</sup> *Id.* § 772(b).

<sup>5</sup> There is also a question of who is a “U.S. person” for these purposes. This question, which has been extensively discussed in CFTC releases, is beyond the scope of this Article.

<sup>6</sup> 17 C.F.R. §§ 30.1–.13 (2012).

<sup>7</sup> *Id.* § 30.5.

<sup>8</sup> *Id.* § 240.15a-6.

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that the fraud was committed in the United States.<sup>9</sup> The Court adopted a transactional test to determine whether section 10 of the Exchange Act applied: “whether the purchase or sale is made in the United States, or involves a security listed on a domestic exchange.”<sup>10</sup> In this case, the Court rejected the notion that the Exchange Act governs conduct taking place in the United States that affects exchanges or transactions abroad based in part on “[t]he probability of incompatibility with the applicable laws of other countries.”<sup>11</sup> While *Morrison* does not address whether U.S. regulation under the CEA should apply to a swap between a U.S. person and a non-U.S. person, it does discuss considerations that should limit the extraterritorial reach of U.S. regulators.

### C. Regulation Under the Dodd-Frank Act

Transaction-Level Requirements: The CFTC has proposed and adopted a number of requirements directly applicable to swaps transactions (transaction-level requirements) as well as rules applicable to regulated entities such as swap dealers (entity-level requirements). Because entity-level requirements do not apply directly to cross-border swaps (except with respect to reporting, as described further below), this Article focuses on transaction-level requirements. The transaction-level requirements are: (i) mandatory clearing of swaps; (ii) mandatory execution (i.e. trading) on a centralized exchange or swap execution facility; (iii) collection of margin on uncleared swaps; (iv) requirements for swap documentation; (v) requirements regarding portfolio reconciliation and portfolio compression; (vi) real-time public reporting of swaps activity; (vii) requirements regarding confirmation of trades; (viii) retention of daily trading records; and (ix) standards for business conduct between swap dealers and their counterparties.<sup>12</sup>

Reporting: In addition to the transaction-level requirements, the CFTC has adopted rules requiring regular and timely reporting of swaps transactions and life-cycle information.<sup>13</sup> While these rules are listed among the entity-level requirements, they clearly affect cross-border transactions and are therefore discussed below.

CFTC interpretive guidance and exemptive order: The CFTC has issued several interpretative guidances and orders related to cross-border swaps. In July 2012, the CFTC issued proposed guidance on extraterritorial application of swap regulation.<sup>14</sup> This was accompanied by a proposed exemptive order to provide relief from certain requirements

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<sup>9</sup> 130 S. Ct. 2869, 2888 (2010).

<sup>10</sup> *Id.* at 2886.

<sup>11</sup> *Id.* at 2885.

<sup>12</sup> Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41,214, 41,225 (proposed July 12, 2012) (to be codified at 17 C.F.R. ch. I).

<sup>13</sup> See Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136 (Jan. 13, 2013) (to be codified at 17 C.F.R. pt. 45); Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, 77 Fed. Reg. 35,200 (June 12, 2012) (to be codified at 17 C.F.R. pt. 46).

<sup>14</sup> See Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, *supra* note 12.

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for cross-border swaps.<sup>15</sup> In December, the CFTC issued a final exemptive order and further proposed guidance regarding cross-border swaps.<sup>16</sup>

The effect of the proposed guidance is that all U.S. transaction-level rules apply, with one exception, to any swap to which a U.S. person is a party.<sup>17</sup> The exception is that non-U.S. branches of U.S. swap dealers that face non-U.S. persons are exempt from transaction-level requirements at least until July 2013.<sup>18</sup>

The broad extraterritorial reach of these requirements has resulted in considerable criticism. In her concurring statement at the time the final exemptive order providing cross-border relief was adopted, CFTC Commissioner Jill Sommers commented that the CFTC's extraterritorial reach seemed to have been guided by the "Intergalactic Commerce Clause."<sup>19</sup> In October 2012, ministerial-level representatives of the U.K., Japan, France, and the European Commission sent a joint letter to the Chairman of the CFTC expressing concerns about the CFTC's regulation of cross-border swaps and urging the CFTC to "take the time to ensure that US rulemaking works not just domestically but also globally."<sup>20</sup> They advocated coordination among their respective regulatory agencies to adopt cross-border rules that would avoid fragmentation of global markets.<sup>21</sup> More recently, Michel Barnier, a Member of the European Commission, publicly criticized the reach of U.S. derivatives regulation as follows: "expanding interpretation of home-grown rules to [derivatives] transactions that are already covered by equally solid foreign rules will only lead to legal conflicts. It will create uncertainty, increase costs and push trade to less well regulated places."<sup>22</sup>

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<sup>15</sup> Exemptive Order Regarding Compliance with Certain Swap Regulations, 77 Fed. Reg. 41,110 (proposed July 12, 2012).

<sup>16</sup> Final Exemptive Order Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 858 (Jan. 7, 2013); Further Proposed Guidance Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 909 (proposed Jan. 7, 2013) (to be codified at 17 C.F.R. ch. I).

<sup>17</sup> This result is indicated in the summary tables at the end of the Proposed Guidance and the Final Order. See Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, *supra* note 12, at 41,237 (Category B table).

<sup>18</sup> Final Exemptive Order Regarding Compliance with Certain Swap Regulations, *supra* note 16, at 861.

<sup>19</sup> Jill E. Sommers, Comm'r, U.S. Commodity Futures Trading Comm'n, Statement of Concurrence: (1) Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, Proposed Interpretive Guidance and Policy Statement; (2) Notice of Proposed Exemptive Order and Request for Comment Regarding Compliance with Certain Swap Regulations (June 29, 2012) (transcript available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/sommersstatement062912>).

<sup>20</sup> Letter from George Osborne, Chancellor of the Exchequer, UK Gov't, et al., to Gary Gensler, Chairman, U.S. Commodity Futures Trading Comm'n (Oct. 17, 2012), *available at* <http://www.fsa.go.jp/inter/etc/20121018-2/01.pdf>.

<sup>21</sup> *Id.*

<sup>22</sup> Michel Barnier, Member responsible for Internal Mkt. & Servs., European Comm'n, Why Global Markets Require Global Rules—and US-EU Cooperation (Feb. 15, 2013) (transcript available at [http://europa.eu/rapid/press-release\\_SPEECH-13-125\\_en.htm](http://europa.eu/rapid/press-release_SPEECH-13-125_en.htm)).

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This international criticism is troubling in light of the international cooperation mandate found in section 752 of the Dodd-Frank Act.<sup>23</sup> This provision requires relevant U.S. regulators, including the CFTC and the SEC, to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of swaps, SB Swaps, swap entities, and SB Swap entities as appropriate to promote effective and consistent global regulation of swaps and SB Swaps.<sup>24</sup> To address the likely incompatibility of U.S. derivatives regulation of cross-border swaps with other countries' derivatives regulations, the extraterritorial reach of the CFTC swap considerations should be reconsidered.

SEC: The SEC has authority over SB Swaps similar to that of the CFTC has over swaps.<sup>25</sup> At the time of writing, however, the SEC has not yet finalized its regulations governing SB Swaps under the Dodd-Frank Act and has yet to address the treatment of cross-border SB Swaps.

#### **D. Proposal**

We do not believe that there is any simple, one size-fits-all remedy for regulation of cross-border swaps. We recognize that some U.S. regulatory oversight is appropriate for cross-border swaps involving a U.S. person as a party. Obviously, harm can be inflicted on the U.S. economy and U.S. market participants through swaps between a U.S. person and a non-U.S. person.<sup>26</sup> The CFTC cites the collapses of AIG and Lehman Brothers as examples of such harm.<sup>27</sup> AIG, an insurance company incorporated in the U.S., suffered enormous financial losses related to credit default swaps entered into with non-U.S. counterparties via its operations in London.<sup>28</sup> Similarly, Lehman Brothers was forced into bankruptcy at least in part due to losses on swaps positions held by its European subsidiary, Lehman Brothers International (Europe), positions that were guaranteed by the U.S. parent company, Lehman Brothers Holding Inc.<sup>29</sup> At the same time, other countries also have an interest in regulating cross-border swaps. Simply requiring that all U.S. requirements apply to any cross-border swap that involves a U.S. person will result in inevitable conflicts with other laws and would effectively terminate, or at least sharply reduce, the cross-border swap market. To repeat the example given above, a swap can only be cleared once and therefore cannot be cleared in both a U.S. clearinghouse and a European clearinghouse. Imposing U.S. requirements without regard

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<sup>23</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 752, 124 Stat. 1376, 1749–50 (2010).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* § 712.

<sup>26</sup> We believe there are also significant issues in defining the term “U.S. person” for these purposes, but those issues go beyond the scope of this Article.

<sup>27</sup> Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, *supra* note 12, at 41,215.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

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to foreign rules would also conflict with the international cooperation mandate found in Title VII of the Dodd-Frank Act.<sup>30</sup>

We propose therefore that each transaction-level requirement be considered separately, and that specific rules be adopted for each type of transaction-level requirement. These rules, when applied to cross-border swaps involving a U.S. person as a party, should reflect the objectives of the relevant transaction-level requirement while taking into account the likelihood (and likely practical impact) of conflict with other countries' laws. We set out our specific suggestions below.

### 1. Clearing

**Requirement:** If the CFTC designates a swap as subject to mandatory clearing, the swap must be cleared through a derivatives clearing organization (DCO) registered with the CFTC or a DCO that is exempt from registration.<sup>31</sup>

**Proposal:** In two recent no-action letters, the CFTC has recognized clearinghouses in Singapore and Japan as eligible to clear U.S. swaps.<sup>32</sup> The no-action relief granted by these letters is conditioned on a requirement that the non-U.S. clearinghouses apply to be registered with the CFTC as DCOs. We suggest that the CFTC establish an application procedure for recognizing other non-U.S. clearing organizations. Under section 2(h)(1) of the CEA, mandatory clearing can occur through a clearing organization that is exempt from registration.<sup>33</sup> In addition, section 5b(h) of the CEA provides that the CFTC may exempt a DCO from registration if it is subject to “comparable, comprehensive supervision and regulation . . . in the home country of the [DCO].”<sup>34</sup> As a result, the CFTC need not require registration as a DCO in all cases where non-U.S. clearinghouses propose to clear U.S. swaps.

### 2. Margin for Uncleared Swaps

**Requirement:** The Dodd-Frank Act requires swap dealers to comply with margin requirements for uncleared swaps as prescribed by the applicable regulators.<sup>35</sup> The CFTC, the SEC, U.S. prudential regulators,<sup>36</sup> and the BCBS/IOSCO Working Group on

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<sup>30</sup> Dodd-Frank Act § 752.

<sup>31</sup> 7 U.S.C. § 2(h) (2012).

<sup>32</sup> Japan Sec. Clearing Corp., CFTC No-Action Letter, CFTC Letter No. 12-56, (Dec. 17, 2012), *available at* <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/12-56.pdf>; Singapore Exch. Derivatives Clearing Ltd., CFTC No-Action Letter, CFTC Letter No. 12-63, (Dec. 21, 2012), *available at* <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/12-63.pdf>.

<sup>33</sup> 7 U.S.C. § 2(h).

<sup>34</sup> *Id.* § 7a-1(h).

<sup>35</sup> *Id.* § 6s(e).

<sup>36</sup> The “prudential regulators” include the Treasury Department (Office of the Comptroller of the Currency), Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration and the Federal Housing Finance Agency. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 731, 764, 124 Stat. 1376, 1703–12, 1784–

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Margining Requirements (WGMR) have proposed margin requirements,<sup>37</sup> which have not yet been finalized.

Proposal: The margin requirements for uncleared swaps will impose standards on the amount of collateral, the models used to determine amounts, the eligible types of collateral, the time for posting of collateral and other issues. Given the many different detailed operational requirements for collateral positing, it will become difficult, if not impossible, for either party in a cross-border transaction to comply with margin requirements imposed by two jurisdictions.

The most recent WGMR release supports the idea of using only the margin requirements applicable to the collecting entity.<sup>38</sup> In addition, the release suggests that if the relevant regulators for each party find the other jurisdiction's rules to be consistent, then the regulators should allow the parties to choose the margin rules of one jurisdiction or another.<sup>39</sup>

The WGMR's suggestion appears to be a sensible idea of dealing with a difficult issue. The CFTC should establish a procedure for reviewing margin requirements of other jurisdictions as they are adopted. Such a procedure could recognize the different categories of swap counterparties—inter-dealer, between dealer and financial users, and between dealer and corporate end-users—and check for consistency within each category.

### 3. Trade Execution

Requirement: Swaps subject to the mandatory clearing requirement must be executed on a centralized trading facility, which may be a designated contract market (DCM), a registered swap execution facility (SEF), or a SEF that is exempt from registration.<sup>40</sup>

Proposal: As with clearing, if the parties to a swap are subject to trade execution requirements in different jurisdictions, an impossible situation can arise. The swap cannot be executed in both jurisdictions. We propose a similar cross-border approach to the approach suggested above for clearinghouses. U.S. regulators can propose a procedure for approving individual foreign DCMs or SEFs. For SEFs, like DCOs, the swaps can be

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96 (2010); 7 U.S.C. § 6s(e).

<sup>37</sup> BASEL COMM. ON BANKING SUPERVISION & BD. OF THE INT'L ORG. OF SEC. COMM'NS, CONSULTATIVE DOCUMENT: MARGIN REQUIREMENTS FOR NON-CENTRALLY-CLEARED DERIVATIVES (July 2012), *available at* <http://www.bis.org/publ/bcbs226.pdf>; BASEL COMM. ON BANKING SUPERVISION & BD. OF THE INT'L ORG. OF SEC. COMM'NS, SECOND CONSULTATIVE DOCUMENT: MARGIN REQUIREMENTS FOR NON-CENTRALLY CLEARED DERIVATIVES (Feb. 2013), *available at* <http://www.bis.org/publ/bcbs242.pdf>.

<sup>38</sup> BASEL COMM. ON BANKING SUPERVISION & BD. OF THE INT'L ORG. OF SEC. COMM'NS, SECOND CONSULTATIVE DOCUMENT, *supra* note 37, at 19–21.

<sup>39</sup> *Id.*

<sup>40</sup> *See* 7 U.S.C. § 7b-3.

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executed through exempted SEFs as well as registered SEFs. The CEA specifically permits the CFTC to exempt a SEF from registration if it is subject to “comparable, comprehensive supervision and regulation . . . in the home country of the facility.”<sup>41</sup> This would be consistent with the approach taken in part 30 of the CFTC’s rules under the CEA, which exempts a broker who trades in foreign futures and options that are executed on a foreign board of trade from certain requirements under the CEA.<sup>42</sup>

#### 4. Swap Documentation and Confirmation

Requirement: Pursuant to CEA section 4s(i), the CFTC has adopted rules that prescribe standards for documentation of the swap counterparty relationship and trade confirmations.<sup>43</sup> These rules specify which documents and information must be exchanged between counterparties to a swap. The required documentation includes trade confirmations and the rules establish time frames during which confirmations must be executed.<sup>44</sup>

Proposal: Conflicting requirements regarding swap documentation in the respective jurisdictions of the counterparties will hinder trade execution and market liquidity. These requirements are primarily driven by the need for dealers to maintain appropriate records. As a result, we propose the following: if only one counterparty to the swap is a swap dealer, defer to the regulation of the swap dealer’s jurisdiction. If both parties are swap dealers, regulators should apply a similar rule to that proposed by the WGMR with respect to margin regulations: the U.S. should evaluate and identify other jurisdictions that have rules that are consistent with U.S. rules. For cross-border swaps involving a U.S. party and a party in such a jurisdiction, the parties should be able to choose which rules will apply.

#### 5. Business Conduct

Requirement: Pursuant to section 4s(h) of the CEA, the CFTC has adopted standards for business conduct by swap dealers entering into swaps with counterparties.<sup>45</sup> These standards include disclosure and due diligence requirements regarding counterparty eligibility and institutional suitability.<sup>46</sup>

Proposal: The application of divergent business conduct requirements to cross-border swaps exposes swap dealers to greater risk of violating regulatory requirements

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<sup>41</sup> *Id.*

<sup>42</sup> *See* 17 C.F.R. § 30.3(a) (2012).

<sup>43</sup> Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 Fed. Reg. 55,904 (Sep. 11, 2012) (to be codified at 17 C.F.R. pt. 23).

<sup>44</sup> *Id.* at 55,945–46.

<sup>45</sup> Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 Fed. Reg. 9734 (Feb. 17, 2012) (to be codified at 17 C.F.R. pts. 4, 23).

<sup>46</sup> *Id.* at 9823–24.



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and the potential for compliance costs to outweigh the economic benefits of entering into swaps. We propose that the applicable business conduct standards should be those of the jurisdiction of the party that is not a swap dealer. This approach provides the non-dealer counterparty the assurance that it will receive the protections afforded by its home jurisdiction.

## 6. Recordkeeping

**Requirement:** All parties to swaps are required to retain records related to swaps transactions under parts 45 and 46 of the CFTC's rules under the CEA.<sup>47</sup> According to these rules, parties are to retain records of certain historical swaps and new swaps for the life of the swap and for a period of at least five years after the termination of the swap.<sup>48</sup>

**Proposal:** Swap dealers are required to keep records as prescribed by the rule. However, the language of the recordkeeping rule is unclear as to its application to counterparties that are not swap dealers and are not U.S. persons. The rule states that counterparties that are not swap dealers but that are "subject to the jurisdiction of" the CFTC shall keep records as required under the rule.<sup>49</sup> It is not clear from this language whether a party outside the U.S. would be required to keep records under these CFTC regulations. Because the recordkeeping requirements apply to any swap party (and not just dealers), applying this requirement to non-U.S. parties is potentially very onerous. To alleviate this and other issues that are likely to arise with cross-border trades, we propose that the applicable recordkeeping requirements should be those of the jurisdiction of the party keeping the records.

## 7. Swap Data Repository Reporting and Real-Time Public Reporting

**Requirement:** Information on swaps transactions must be reported to a swap data repository (SDR) within time frames specified in the CFTC's SDR reporting rules.<sup>50</sup> The CFTC's rules also require SDRs to disseminate specified trade information to the public on a real-time basis.<sup>51</sup>

**Proposal:** If different reporting requirements apply to a cross-border trade, issues may arise if counterparties report inconsistent information to SDRs. In addition, market

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<sup>47</sup> Swap Data Recordkeeping and Reporting Requirements, *supra* note 13; Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, *supra* note 13.

<sup>48</sup> See Swap Data Recordkeeping and Reporting Requirements, *supra* note 13, at 2197–99; Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, *supra* note 13, at 35,226–28.

<sup>49</sup> See Swap Data Recordkeeping and Reporting Requirements, *supra* note 13, at 2198.

<sup>50</sup> See *id.* at 2199–2202; Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, *supra* note 13, at 35,227–28.

<sup>51</sup> See 7 U.S.C. § 2(a)(13) (2012); Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182 (Jan. 9, 2012) (to be codified at 17 C.F.R. pt. 43).

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participants may have difficulty in accessing and analyzing complete trade records if information is reported to and housed in different SDRs in different jurisdictions. We suggest that for swaps executed on an SEF or cleared through a DCO, the rules of the jurisdiction of the SEF or DCO apply. For all other swaps, we suggest that the regulators make every effort to harmonize their reporting requirements so that the same information can be used for U.S. and non-U.S. SDRs.

## **8. Portfolio Reconciliation and Compression**

Requirement: Swap dealers are required to reconcile with their counterparties on a regular basis, with minimum frequencies established by the CFTC's rules.<sup>52</sup> Swap dealers are also required to establish procedures to perform portfolio compression exercises.<sup>53</sup>

Proposal: These portfolio-related requirements generally require participation and cooperation of both counterparties to a swap. If parties to a cross-border trade are subject to inconsistent portfolio-related requirements, compliance may not be possible. We propose that, if only one party to the cross-border swap is a swap dealer, the rules of the swap dealer's jurisdiction apply. If both parties to the cross-border swap are swap dealers, then we suggest, as for margin and swap documentation, that the U.S. regulators determine which foreign jurisdictions have rules consistent with U.S. rules. For cross-border swaps involving a U.S. party and a party in such a jurisdiction, the parties should be able to choose which rules will apply.

## **III. Conclusion**

The broad extraterritorial reach currently espoused by the CFTC for cross-border swaps is inconsistent with the Dodd-Frank Act's international cooperation mandate and has the potential to significantly disrupt the swaps markets. If a cross-border swap were made to comply with divergent regulations of two countries, it would expose swap dealers to the risk of violating regulatory requirements and could make compliance cost outweigh the economic benefits of entering into swaps.

We recognize that some U.S. regulatory oversight is appropriate for cross-border swaps that involve a U.S. person and acknowledge that there is no simple, one size-fits-all approach for regulating cross-border swaps. To avoid significant practical obstacles to cross-border swap transactions, we suggest a framework that applies each type of transaction-level requirement to non-U.S. persons on a rule-by-rule basis, taking into account the objectives of the relevant transaction-level requirement and the likelihood of incompatibility with other countries' regulations.

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<sup>52</sup> Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, *supra* note 43, at 55,927–28.

<sup>53</sup> *Id.* at 55,932–36.