INTRODUCTION TO THE U.S. REGULATION OF CROSS-BORDER TRANSACTIONS INVOLVING SWAPS AND SECURITY-BASED SWAPS

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This practice note provides an introduction to U.S. regulation of swaps and security-based swaps executed or negotiated outside the United States that involve at least one U.S. person or certain affiliates thereof, and at least one counterparty that is not organized under U.S. law, which are commonly referred to as "cross-border transactions."

BACKGROUND

On July 21, 2010, Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") amended the Commodity Exchange Act ("CEA") and the Securities Exchange Act of 1934 (the "Exchange Act") to provide for the comprehensive regulation of swaps and security-based swaps, respectively. Public Law 111-203, 124 Stat. 1376 (2010). For an explanation of the difference between swaps and security-based swaps, please refer to the practice note, "Introduction to the Regulation of Swaps and Security-Based Swaps Under Title VII of the Dodd-Frank Act."

The financial crisis of 2008 demonstrated that cross-border activities can have a substantial impact on the U.S. financial system. U.S.-based companies faced enormous financial losses and credit downgrades when counterparties called for additional collateral on swap positions with the foreign affiliates and subsidiaries of the U.S.-based companies, resulting in liquidity problems for both counterparties and systemic difficulties in both foreign and domestic financial markets.

The Dodd-Frank Act responded to the problems that arose from cross-border transactions by providing a basis for extraterritorial jurisdiction. As discussed below, the fundamental basis of extraterritoriality is different in both statutes as the CEA is focused on the effect of global swaps markets on the financial stability of the United States, while the Exchange Act regards security-based swaps as an object of securities regulation. The Commodity Futures Trading Commission ("CFTC") has implemented the statutory provisions regarding extraterritorial application through interpretive guidance. Similarly, the Securities and Exchange Commission ("SEC") has adopted the first in a series of final rules and interpretative guidance on cross-border security-based swap activities.

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