



## **Summary**

SIFMA, ISDA and IIB have filed a legal challenge to the CFTC’s Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations (“Cross-Border Rule”), and to the cross-border aspects of related rules. The lawsuit alleges that the CFTC:

- Unlawfully circumvented the requirements of the Administrative Procedure Act and the Commodity Exchange Act by characterizing its regulations as “guidance”;
- Failed to conduct any cost-benefit analysis as required by law;
- Conducted a flawed rulemaking process; and
- Imposed a series of rules that are contrary to the spirit and the letter of international cooperation and may harm global markets.

The Associations believe that:

- The agency did not appropriately follow the laws enacted by Congress in issuing regulations related to the cross-border application of certain aspects of the Dodd-Frank Act. The route it chose circumvented the normal rulemaking process set by the Administrative Procedure Act and Commodity Exchange Act. The end result is that market participants will face rules that are duplicative, overlapping and contradictory.
- The Cross-Border Rule contravenes existing agreements between global policymakers.
- The CFTC’s overreach could cause fragmentation of global markets which will result in reduced liquidity, significant harm to market participants and the impairment market-based financing.
- It could also create significant financial, legal and administrative burdens on market participants that could harm liquidity and the ability of end-users to manage their risks.

## **Background**

There is global consensus among policymakers and market participants regarding the goals and structure of regulatory reform initiatives involving OTC derivatives.

Legislation has been passed in the U.S. to achieve that reform. Legislation has also been passed in other jurisdictions, including the EU, and additional legislation is being finalized there. The next steps of the reform initiative are now underway globally.

While there are differences in timing of the legislation and regulatory implementation, there is a significant level of alignment in terms of the objectives, approaches and outcomes being taken in respective jurisdictions.

The goal of reform efforts in the U.S., EU, Asia and other jurisdictions are similar. As the CFTC-EC joint statement, the "Path Forward", of July 11, 2013 said: "As a result of the joint collaborative effort, in many places, final rules are essentially identical, even though the regulatory calendars are not always synchronized."

Because the reforms will be highly similar, global policymakers recognize the need to avoid overlap, duplication and contradictory requirements. As stated in the July 11, 2013 Path Forward:

"As the market subject to these regulations is international, it is acknowledged that, notwithstanding the high degree of similarity that already exists between the respective requirements, without coordination, subjecting the global market to the simultaneous application of each other's requirements could lead to conflicts of law, inconsistencies, and legal uncertainty."

The CFTC's Cross-Border Rule and the agency's subsequent interpretations under that Guidance, undermine the global commitment to prevent contradictory, overlapping and duplicative requirements in several ways.

- As a result of the confusing process around the development of the CFTC's Cross Border Rule (and subsequent releases) and the CFTC's lack of coordination with the SEC or foreign regulatory bodies, non-U.S. counterparties have become increasingly reluctant to transact with U.S. based dealers or even with non-U.S. dealers that have U.S.-based personnel involved in the transaction.
- Potential contradictory requirements (clearing): Under the CFTC's Cross-Border Rule, a non-US swap dealer that is transacting with a non-U.S. customer could be required to comply with the CFTC's transaction-level requirements if the dealer's U.S. office assists in the transaction. This means that **the same trade would be required to be cleared at both a U.S. and a non-U.S. clearinghouse.**
- Potential contradictory requirements (trade execution): In the above example, the counterparties might need to comply with the trade execution requirements of both jurisdictions. This potentially means that **the same trade would need to be executed on both a U.S. trading platform (SEF) and a non-U.S. trading platform.**
- Duplicative requirements (trade reporting): In the above example, the swap dealer could also be required to **report the transaction to trade repositories in both jurisdictions.** This could undermine one of the goals of regulatory reform by making it harder for regulators to understand where risk is in the system.
- Overlapping requirements: Non-US counterparties of CFTC-registered swap dealers would need to understand and comply with the CFTC's transaction-level requirements, in addition to the requirements in their own jurisdictions, adding to their administrative, legal and

regulatory costs, with no countervailing benefits to the counterparty or to the financial system.

- **Competitive Impact:** Non-U.S. counterparties will elect to face dealers that are not subject to CFTC regulations to avoid compliance with both their own local and CFTC regulations.

CFTC relief provided thus far is inadequate in scope and/or time limited, leaving critical uncertainties pending. The CFTC has also given no indication whether it will rescind the overlapping or contradictory regulations if and when it finds the regulations of other jurisdictions to be equivalent to U.S. regulations.

CFTC Commissioner Scott O'Malia stated in September: "...the guidance failed to justify its overbroad extraterritorial reach under the statute's 'direct and significant' standard. This standard was in fact meant to be a limitation on the Commission's authority, not an invitation to bring the world under the Commission's jurisdiction. Second, in staking out such an overbroad position, the guidance failed to give sufficient consideration to principles of international comity. Third, the Commission should have issued the document as a rulemaking, not as an "interpretative guidance."

Policymakers have also expressed concerns about the CFTC's recent actions, including the November 14<sup>th</sup> [Cross-Border](#) and November 15<sup>th</sup> [SEF](#) Advisories. The European Commission has stated it was "very surprised by the latest CFTC rules which seem to us to go against both the letter and spirit of the path forward agreement," and that the rules "are another step away from the kind of inter-operable global system that we want to build."

Lawmakers criticized Gensler for setting regulation by guidance:

Representative Scott Garrett called the move illegal. "We clearly have an agency chairman gone rogue," "Since when did it become acceptable for the chairman of the CFTC to change law and commission-approved guidance though an advisory opinion issued by staff at his discretion?"

Representative Frank Lucas of Oklahoma, Chairman of the House Agriculture Committee that oversees the CFTC, called on the agency to immediately issue a public statement clarifying the rules so markets wouldn't be disrupted. "Regulations market participants thought were in place changed overnight without warning or consultation."

As a result of these factors, SIFMA, ISDA and IIB filed a legal challenge. The complaint makes clear that the Associations' members support vigilant regulation of the derivatives markets to improve transparency and mitigate systemic risk, and have attempted in good faith to comply with the CFTC's improperly-adopted regulations. However, Plaintiffs are compelled to bring this action now to stop what is proving to be an unceasing effort by the Commission to regulate the global swaps markets through unpredictable "guidance" documents, advisories, and directives, and to force the CFTC instead to abide by the requirements for rulemaking laid down by Congress.

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