Dodd Frank Act and the Brazilian Capital Market – Extraterritorial Effects of Regulation to the Over-the-Counter Derivatives Market

Alexandre Ramos Coelho

São Paulo Law School of Fundação Getulio Vargas – DIREITO GV

March 2014


Please do not quote without author’s permission

---

* Final Paper presented to the course “Capital Markets Law and Development”, taught by Professor Francisco Satiro (July 2013).

1 Master Candidate in Law and Development at Direito GV.
Abstract: This paper aims to describe the chief alterations proposed by the Dodd Frank Act to the American over-the-counter derivatives market and, at the same time, understand the extraterritorial reach of this law compared to the regulatory framework of the Brazilian derivative market. In order to do so, I will study the extraterritorial effects of the law, particularly in reference to the international nature of Title II of the Dodd Frank, which deals with the over-the-counter derivatives, in order to evaluate its reach to foreign markets, especially the Brazilian market.

Keywords: Dodd Frank; derivatives; Brazilian derivatives market; Clearing House; extraterritorial effect.

Contents

1 Introduction .................................................................................................................. 3
  1.1 Over-the-counter derivatives and the International Financial Crisis ...................... 4
2 Overview – The International Character of Title VII of the Dodd Frank Act and the Brazilian Derivative Market ........................................................................... 7
  2.1 Recording and Reporting Operations ...................................................................... 8
  2.2 Swaps – Negotiation Platforms .............................................................................. 9
  2.3 Clearing Systems .................................................................................................... 9
  2.4 Deposit of the Margin – Derivatives Operations Settled via the Clearing Systems ___ 10
  2.5 Deposit of the Margin – Derivatives Operations not Settled via the Clearing Systems 11
  2.6 Brazilian Derivatives Market vis à vis Title VII of the Dodd Frank Act .............. 12
3 Over-the-counter Derivatives and the Extraterritorial Reach of Title VII of the Dodd Frank Act ........................................................................................................... 15
  3.1 Effects of the Extraterritoriality of the Dodd Frank Act over the Derivatives Market and Participants of the Market / Difficulties and Solutions .................................................. 18
    3.1.1 Loss of Competitiveness of American Institutions ............................................. 18
    3.1.2 Duplicated and Overlapping Regulations ......................................................... 19
    3.1.3 Regulatory Arbitration ..................................................................................... 20
  3.2 Brazilian Derivative Market .................................................................................. 21
4 Final Considerations .................................................................................................... 24
References ...................................................................................................................... 25
1 Introduction

After the devastating wave that was the international financial crisis, regulatory responses began to emerge from the main financial centers of the world, in an attempt to cope with the demands from taxpayers, investors and governments in these financial centers\(^2\), aiming to contain or minimize the economic consequences that a new financial crisis of global proportions might cause in the future. It was in this scenario that president Barack Obama signed on July 21, 2010, Federal Law 111 -203, the so-called Dodd-Frank Wall Street Reform and Consumer Protection Law (“Dodd Frank Act”)\(^3\).

Amongst the several issues regulated by the new law, stand out the principles intended to control systemic risk in financial and capital markets, rules protecting financial consumer rights, regulations directed at rating agencies, compensation of financial executives, proprietary operations of investment banks and the over-the-counter derivatives markets. The latter was responsible, until June of last year, for 639 trillion of dollars in international operations involving over-the-counter derivatives, in accordance to data from the Bank for International Settlement- BIS\(^4\).

Considering the international scope, it is obvious that the financial crisis caused billionaire losses to the private and public sectors, as well as to the population in general, notably taxpayers and investors in central economies. Brazil, on the other hand, although coping relatively well with the crisis, was not immune to global growth in the derivatives market. The financial crisis provoked the devaluation of the Brazilian currency, the real, causing losses to Brazilian companies that made operations in exchange-rate derivatives. In 2008, at the height of the financial crisis, operations with these derivatives performed by Sadia and by Aracruz Celulose resulted in financial losses around R$6 billion\(^5\).

At the end, considering not only the mentioned companies, the total losses for the Brazilian private sector in 2008 involving international operations with over-the-counter derivatives reached approximately 25 billion dollars as result of the international financial

---

\(^2\) Example: G20 Countries (Brazil, United States, United Kingdom, Russia, France, Germany, Italy, Australia, Japan, China, South Africa, Canada, etc.). Available at: <http://www.g20.org/>.

\(^3\) CCH ATTORNEY-EDITOR STAFF (2010, p. 1).


crisis, also according to data from Bank for International Settlement – BIS\(^6\). These figures show the relevance of this market to international finances and reinforces the understanding that Brazil is necessarily connected – via the over-the-counter derivatives market – to the international financial market, particularly to its companies, banks, managers and economic agents in general, based on or associated to financial and capital markets.

Therefore, the Dodd Frank Act, whereas still on a clear path to be regulated and implemented by regulatory American agencies (CFTC and SEC)\(^7\), represents the first and major legal reform of the financial and capital American markets since 1930\(^8\), at the same time, reflecting and meeting the demands of the G20 countries, for greater transparency and control of the over-the-counter derivatives market.

Hence, the objective of this article is to describe the chief alterations proposed by the Dodd Frank Act to the American over-the-counter derivatives market and, at the same time, understand the extraterritorial reach of this law compared to the regulatory framework of the Brazilian derivative market. In order to do so, the article is structured in a way where in item 1 we will elucidate the role of derivatives in the international financial crisis.

In item 2, a general description of the main points regulated by the Dodd Frank Act, particularly in reference to the international nature of Title II of this law, which deals with the over-the-counter derivatives market. In item 3, special attention will be given to the extraterritorial effects of the law, where we will attempt to evaluate its reach to foreign markets, especially the Brazilian market.

Finally, the main criticisms referring to the extraterritorial reach of the Dodd Frank Act will be evaluated, leaving item 4 to deal with the final considerations.

1.1 Over-the-counter derivatives and the International Financial Crisis

Generally, the source and the beginning of the international financial crisis was centered around the massive defaulting in mortgage contracts of properties that were the collateral for securitized receivables that were negotiated in international financial market by investment banks. However, the aggravation of the crisis occurred as result of the sophistication and the innovation in the area of the so called credit derivatives.


\(^8\) According to ACHARYA (2011).
Over-the-counter derivatives, when compared to stock market derivatives, are characterized by: (i) non-standardization in their contractual clauses and consequently a greater flexibilization of its clauses when compared to the specifications of stock market derivatives; (ii) bilateral and direct negotiation between the parties (generally between financial institutions and their clients, companies and banks, or still, direct negotiation between the institutions themselves); and (iii) direct execution between the parties (absence of a central guaranteeing counterparty, as, for instance, a Clearing House\(^9\)).

According to Yazbek\(^10\):

> [...] the over-the-counter market can be defined as that decentralized environment, where negotiations are closed directly between the parties, with the use of several means (by phone, electronic systems, etc.) where the parties have a greater capability to comply to the terms and the conditions of the performed operations.

These three characteristics that are intrinsic to derivative contracts result in: (i) opacity or lack of transparency in the over-the-counter derivatives market in a way that it is hard to quantify and manage the risks that exist in these markets; (ii) difficulty to control and track negotiations carried out with these instruments; and (iii) indiscriminate utilization and negotiation of these instruments, aiming excessive financial speculation and its non-utilization in the protection against credit risks, for example.

Credit derivatives, on the other hand, are associated to the management of credit risk. These instruments have the objective to help investors, financial institutions and companies to manage the credit risk of their operations in financial and capital markets. It works like an insurance against default risks associated to the payment of debts from defaulting borrowers\(^11\). Among the several derivatives that compose the over-the-counter market\(^12\), instruments known as Credit Default Swaps (“CDSs”) and Credit Debt Obligations (“CDOs”) stood out during the crisis, which are over-the-counter derivatives that having been negotiated

---

9 In the Brazilian Stock Exchange there is a department specialized in clearance, settlement, depository and risk management activities. This department covers the equities, equity derivatives, derivatives, OTC derivatives and corporate bonds markets.

10 According to YAZBEK (2007, p. 15 ss.).


independently from guarantees or collaterals from mortgage contracts that originated them, provoked the escalation of the international financial crisis, contributing for the destabilization of the American International Group (AIG) and the collapse of the Lehman Brothers Bank.

Considering that it is not the intention of this text to deal in detail with the concepts and structures of operations with credit derivatives that helped to destabilize the international financial system, it will be sufficient to describe in a concise manner the way they work, in order to highlight the indiscriminate use of CDSs and CDOs contracts. Therefore, we have CDS, which is a derivative contract that provides insurance against the risk of default of a particular company that, for instance, has issued debt securities and intends to reimburse the principal and pay interest to creditors that have acquired these securities. This company is named as reference entity and the default in the payment of interest by it is considered a credit event\textsuperscript{13}.

A typical CDS operation occurs when the defaulting risk of a reference entity is transferred from one party (seller) to the other (risk buyer). In this case, the seller pledges to pay to the risk buyer a premium (\%) over the total amount to be guaranteed, in accordance to the terms of the CDS contract. The risk buyer, on the other hand, pledges to reimburse and pay to the seller the losses that it has suffered because of the credit event (breach from the issuing company or the reference entity, for instance). However, before the outbreak of the financial crisis, CDS operations were not performed with the intention to protect or hedge against financial risks. Quite the contrary, speculation and leverage instruments were utilized by financial institutions and investors, particularly because these operations were financially settled, regardless of collateral, control and oversight\textsuperscript{14}.

CDO, on the other hand, emerged with the securitization of real estate loans backed up by mortgage contracts\textsuperscript{15}, in a way that the combination between the operations involving CDSs and CDOs, carried out and settled bi-laterally, without control and transparency or external monitoring, in an informal way, with pricing regulated exclusively by the parties and, above it all, no regulation and supervision by the authorities from financial and capital markets, led to the generalized collapse of banks, companies and investors when a series of mortgage contracts entered into default by individuals that borrowed from banks that provided the housing credit.

\textsuperscript{13} HULL, 2009b, p. 515.
\textsuperscript{14} For an explanation and a detailed description how CDS and CDO contracts work, see ALMEIDA (2011, p. 167 ss.).
\textsuperscript{15} For a detailed study of the operations with CDS and CDO, check ALMEIDA (2011, p. 167 ss.).
By bringing a little bit more sophistication to the combination of operations involving over-the-counter derivatives, we can locate the institutions and investors in different countries where the same institution or investor were – simultaneously – borrower and creditor to other investors. Add to this the abrupt drop in the liquidity of international markets, when everyone wanted to redeem their papers, and lack of public records or transparency in contractual relationships where borrowers and creditors were not identified. The stage was set for one of the main sources of systemic risk for the international financial market and the important participation of over-the-counter derivatives market.

With this brief introduction, I move on to a general description of chapter II of Dodd Frank Act, of its international characteristics and the regulatory framework of the Brazilian derivative market.

2 Overview – The International Character of Title VII of the Dodd Frank Act and the Brazilian Derivative Market

The Dodd Frank Act is broadly described and esteemed as the most ambitious and relevant regulatory reform project for the financial and capital markets since the thirties. Along with other regulatory reforms promoted by the American Treasury, by the FED and by the United States government itself, this law will profoundly change operational and regulatory aspects of not only the financial and capital American markets, but also international markets.16

In general lines, among others, Dodd Frank promotes changes17: (i) in the role of the Federal Reserve (FED), so that, besides the control of inflation and employment, one of the new missions of the FED that has been expressly established by the new law will be to monitor and maintain financial stability; (ii) in proprietary operations of the banks with the Volcker Rule. This is a controversial rule which is still in the process of being regulated by American authorities. In a summarized way, this rule prohibits bank institutions to perform proprietary operations. For example, operations involving short-term financial speculations for its own portfolio, except in the case of operations with government bonds, also preventing the participation of banks in hedge funds; and (iii) in the over-the-counter derivatives markets. Among other equally important measures, the Dodd Frank Act also regulates, in a

16 According to ACHARYA (2011, p. 1).
17 According to CCH ATTORNEY-EDITOR STAFF (2010, p. 60).
comprehensive manner, the operations and the conduct of institutions that operate in the *de over-the-counter derivatives market*\(^{18}\).

Title VII of the Dodd Frank Act, which regulates the over-the-counter derivatives market, intends, by the means of new regulations, to provide to this market the same characteristics that exist in regulated markets of the stock market today\(^{19}\). Among other measures, are: (i) the requirement that swap contracts be settled via a guaranteeing central counterparty that is duly regulated (“Clearing Houses”); and (ii) a required deposit at the *Clearing Houses* for the initial guarantee margin, as well as necessary guarantees to maintain this margin.

In addition, those swap operations that have been settled via Clearing Houses must also be executed and negotiated via negotiation systems already in place or created to make possible the negotiation of these swap contracts, such as stock markets or platforms or electronic systems specifically structured with the objective to record and negotiate swap contracts\(^{20}\).

2.1 Recording and Reporting Operations

In accordance to the Dodd Frank Act, swap contracts must be reported to and registered at entities named “*Swap Data Repositories*”\(^{21}\) (“Recording Entities”) or still, in accordance to its own regulation still to be ratified, can be reported and recorded at the CFTC or at the SEC. In compliance with this norm, all the operations must be reported and recorded, including those operations that are considered exempt by Dodd Frank\(^{22}\) related to the negotiation and settlement of operations in negotiation systems and in clearing houses. These entities will be responsible to record and store information related to swap transactions.

The information that must be reported to this Recording Entities, includes, among other things: (i) the security amount underlying the derivative; (iii) the dates the contracts were signed and when they will mature; (iv) the identity of the counterparties, brokerage firm and operations desk (non-public information); and (v) the criteria and formulas for the pricing in the contracts.

---

\(^{18}\) Known in the international financial market as o Over the Counter Market or OTC Market.

\(^{19}\) According to MILLER and RUANE (2012).

\(^{20}\) These deposit and settlement institutions – Clearing Houses – must demand adequate guarantees and margins from the parties as the initial margins become exhausted or are not sufficient for a particular operation, keeping records of the positions and monitor risks.

\(^{21}\) According Sections 723(a)(3) and 763(a) of the Dodd Frank Act.

\(^{22}\) According to Sections 3103 and 3203 – H.R. 4173.
(non-public information). Finally, the parties must keep records regardless of their swap operations, keeping them at the disposal of the regulatory authorities (examples: CFTC or SEC)\textsuperscript{23}.

These mandatory and centralized records will promote the transparency in the over-the-counter derivatives market, so that parties, mediating parties, investors and regulatory authorities can access an important source of information aiming to facilitate market supervision and control activities.

2.2 Swaps – Negotiation Platforms

According to the Dodd Frank Act, Title VII, swaps and swaps contracts referenced by securities (security-based swaps) will have to be settled by the means of Clearing systems. These must also be negotiated in stocks markets or negotiation platforms for swaps contracts. The objective of this rule is to promote the transparency of prices in the swaps market and discourage the closing of contracts in a bi-lateral manner, promoting negotiations in more formal systems, like the stock market, for instance\textsuperscript{24}.

Still, according to American rules, electronic negotiation systems should allow multiple actors, bidding and accepting bids, considering that the over-the-counter derivatives market is denser with pricing information only available to the negotiators or to the parties that are signing the contract, not existing transparency in relationship to the prices practiced in this market\textsuperscript{25}.

2.3 Clearing Systems

The majority of derivatives contracts – according to Dodd Frank – which before were negotiated exclusively in the over-the-counter market must be, with some exceptions\textsuperscript{26}, settled via Clearing systems\textsuperscript{27}, including international operations involving swap contracts.


\textsuperscript{24} According to Section 723 of the Dodd Frank Act (section 5b(e) of the Commodity Exchange Act).

\textsuperscript{25} Ibidem; and MILLER and RUANE (2012).

\textsuperscript{26} This subject is still in the process of being regulated by the CFTC and by the SEC. For detailed information, check: Title VII – PART II – REGULATION OF SWAP MARKETS – CFTC – Section 723 of the Dodd Frank Act, and Title VII – PART II – REGULATION OF SWAP MARKETS – SEC – Section 763(a) of the Dodd Frank Act.

\textsuperscript{27} According to Gastineau and Kritzman in the Dictionary of Financial Risk Management of the BM&F (1999), Clearing: “Affiliate or subsidiary of a future or securities exchange that performs the settlement of
According to the new law, the Clearing House becomes the central counterparty that guarantees all derivative contracts that have been recorded at it, so that the investor, the company or the bank that performed the swap operation ("trader") do not have to worry about a breach or default from the counterparty, becoming the responsibility of such Clearing House to guarantee the financial settlement of the operation and the respective financial reimbursements or payment to the respective counterparty.

2.4 Deposit of the Margin – Derivatives Operations Settled via the Clearing Systems

However, the credit risk remains, even when operations are settled via an efficient system by the means of a Clearing House, since one of the parties in a derivative contract might not honor its obligation, leaving it to the Clearing House to guarantee the payment of the defaulting party to the other counterparty. This way, the Clearing House depends on a system of guarantees or margins to cover potential losses.

Therefore, the Dodd Frank Act, in the item about swaps operations\(^\text{28}\), deals with the mandatory deposit of the initial margins or guarantees at the respective Clearing House so that the derivative operation might be settled by it\(^\text{29}\). Therefore, before the execution of the operations. It requires from its members guarantees for the transactions from its own portfolio or its clients’ portfolio with future and options contracts”. In Brazil, before the fusion between BM&F and BOVESPA, existed the Brazilian Company for Liquidation and Custody (“CBLC”), a joint stock, closed capital company responsible for the deposit, custody, settlement and risk management of all the operations made at the negotiation systems of BOVESPA. BM&F, on the other hand, had a system of derivatives Clearing, commodities, and currency exchange that implemented the settlement of operations with derivatives carried out in its negotiation systems (departments inside the administrative structure of BM&F). Currently, BM&FBOVESPA has a Clearing system that performs all the operations that are necessary for the appropriate settlement and liquidation of the operations with derivatives negotiated in its negotiation systems. This Clearing system is not constituted by independent companies as in the past (example: CBLC). Clearing systems for stocks, derivatives and currency exchange are managed by specific departments inside the stock market itself. For a more in-depth approach to the issue, verify the Manual of Operational Systems of the Derivatives House, Segment BM&F, available at: <http://www.bmfbovespa.com.br/pt-br/geral/abertas/mo-mpo-camara-derivativos.pdf>. Last visited: July 10, 2013. In Brazil, Law 10.214/2001, defines Clearing as “systems of recording, settlement of operations”.

\(^{28}\) Ibid. Variation Margin or Daily Adjustment: “Financial transference that occurs after each trading day (sometimes, on the same day), in the majority of the future markets, to mark sold and purchase positions at the market. Differently from a future contract – whose settlement occurs only at maturity - the majority of the future contracts is daily settled, by the means of the payment of the adjustment amount by the party that suffered losses in that day to the party that obtained profit”. Still, according to Gastineau and Kritzman, Maintenance Margin: “In addition to the initial margin deposited at the stock, futures and options markets, there is the requirement of an additional deposit by one or both parties of an operation, if the initial margin is not sufficient to guarantee the compliance with their obligations. Normally, a maintenance margin is not demanded over positions purchased in options, for, in order for them to be exercised, they must be fully paid. In the futures market, the maintenance margin is commonly named “additional margin”.

\(^{29}\) According to Section 736, Title VII, Part II (Regulation of Swap Markets) of Dodd Frank Act.
operations, the parties must deposit initial guarantees *(initial margin)*\(^{30}\) at the respective Clearing House to cover eventual defaults. At the end of each day, on the other hand, the contracts will be priced again – by a system known as *mark-to-market*\(^{31}\) – and all those that suffered losses in the variation margin of the derivative contract, will be beckoned to deposit additional guarantees *(margin call)*\(^{32}\) and must deposit these guarantees to cover the daily losses before the next operation is carried out *(variation margin or maintenance margin)*\(^{33}\).

### 2.5 Deposit of the Margin – Derivatives Operations not Settled via the Clearing Systems

As a general rule, the objective of Dodd Frank, even from an international point of view, is to promote the standardization of the over-the-counter derivatives markets by the means of negotiation via the stock market and, particularly, by means of settlement of over-the-counter derivatives via Clearing systems\(^{34}\). However, it needs to be pointed out, something that is acknowledged even by the norm itself and American regulators, that not all the contracts can be standardized to be settled by the means of clearing houses\(^{35}\).

This way, in Abril, 2011, CFTC proposed rules to demand margins for bi-lateral operations involving derivatives contracts that cannot be standardized at the stock exchanges and Clearing Houses\(^{36}\). We can mention as example the deposit of margins or guarantees at banks that provide the services of custody and management of guarantees. In swap contracts,

---

\(^{30}\) According to Gastineau and Kritzman in the *Dictionary of Management of Financial Risk of the BM&F* (1999), Initial Margin: “Guarantee deposit or performance insurance deposited with a broker when it is assumed a position in derivatives or in an asset. The initial margin can be determined by government agencies (in the United States, the sector of the Federal Reserve Board in charge of bonds and securities) or by the stock market where the instrument is negotiated (future contracts). If the broker that loads and executes the position thinks that the minimum margins does not confer to his clients a firm protection, he can ask for a higher amount”.

\(^{31}\) In accordance to technical information provided by the Miller and Ruane (2012). As far as the definition of *mark-to-market* is concerned: DOWNES and GOODMAN, in the Dictionary of Financial and Investment terms of BOVESPA (1993), mark-to-market corresponds to: “Readjust a security or a portfolio according to the current market values. For example, the margin accounts are adjusted to the current market values to insure the compliance with their maintenance requirements ”.

\(^{32}\) Ibidem. Called Margin Call: “Mandatory additional deposit in cash or additional guarantee, made by a broker or a dealer, to insure the compliance with the obligations resulting from a position.”

\(^{33}\) Ibidem. Maintenance Margin: “In addition to the initially deposited margin at the stocks, futures and options market, there is the requirement for an additional deposit by one or both parties in an operation, if the initial margin is not sufficient to guarantee the compliance with their obligations”. As to the Variation Margin, Gastineau and Kritzman clarify that it refers to: “Financial transference that occurs after each trading day (sometimes, in the same day), in the majority of future markets, to mark positions that have been purchased and sold at market. Differently from a forward contract – whose liquidation occurs only at maturity (sic) -, the majority of futures contracts is settled daily, by the means of payment of the variation margin by the party that suffered losses that day to the party that earned profits”.

\(^{34}\) CCH ATTORNEY-EDITOR STAFF (2010, Section 3060, p. 276).

\(^{35}\) Ibidem, p. 277.

\(^{36}\) Dodd Frank Act, Section 731 and Federal Register Volume 76, number 82, 23732, 17 CFR pt 23.
the parties will make the margin deposits at the referred bank, which will be considered a third party in relationship to the parties of the respective contract.

2.6 Brazilian Derivatives Market vis à vis Title VII of the Dodd Frank Act

Sole Regulator – CVM. In Brazil, in reference to the first jurisdiction that will regulate and supervise over-the-counter derivatives markets, it belongs to the Securities Commission (“CVM”) the responsibility to regulate and supervise operations with derivatives, both, stock or over-the-counter. Why so? Derivatives, as set forth by Law 6.385/76, are securities, regardless of the underlying assets. This way, the regulatory perimeter associated to the over-the-counter derivatives market is adequately defined, not existing gaps related to the regulation and the supervision of this market in Brazil.

Previous Approval of the Contractual Models. In addition, all the models – or the specifications – of the derivatives contracts intended for negotiation in the stock markets are previously approved by CVM or – if they are over-the-counter derivatives – approved by BM&FBOVESPA or by CETIP37, according to the case, in accordance to the terms of Instruction CVM 467/200838. This is an obligation that is applicable to the stock exchanges, entities that manage the over-the-counter market and economic agents in general that exists in Brazil since 198639. According to Yazbek40, in view of the requirement for prior approval of derivatives contracts, it prevails in Brazil “a standardization level that is quite superior than some markets”. In this case, stand out, for instance, United States and countries of the European Union with low level of standardization in their derivative markets, one of the reasons that led the United States to regulate the over-the-counter derivatives markets, requiring a prior recording of all contracts in Recording Entities.

Mandatory Recording of Operations with Derivatives Contracts. Differently from what happens in the derivative markets of the United States, especially before Dodd Frank was passed, in Brazil over-the-counter derivatives contracts were already – mandatorily – recorded at an institution that managed the organized over-the-counter market. The recording of over-the-counter derivatives operations in recording systems authorized by the Central Bank or by CVM has been

38 The current instruction replaced Resolution CMN 1.190/86, which equally discusses the requirement for a previous approval of models and standards in derivative contracts.
39 In view of Resolution CMN 1.190/86.
40 According to YAZBEK (2013).
mandatory since 1994, based on Resolution CMN 2.042/94\textsuperscript{41}. In 2011, however, according to Yazbek, Law 6.385/76 was altered\textsuperscript{42}, making the rationale for prior recording stricter, for “the recording of derivatives operations became a condition for the very validity of the contracts”.

As it can be seen, measures for transparency an control were adopted in Brazil a long time before the international financial crisis and the emergence of Dodd Frank, so that we already had a culture for record keeping, transparency and control of the derivative markets, when compared to the American market. Still, according to Yazbek, our system for prior recording of operations involving over-the-counter derivatives proved important during the crisis, making possible for our regulators to have the information necessary to anchor some regulatory measures passed by Brazil in 2008 at the height of the international financial crisis\textsuperscript{43}.

**Operations with Over-the-counter Derivatives Carried out in Negotiation Platforms and Settled in Clearing Systems.** In reference to the themes related to the negotiation and settlement of swap and derivatives contracts in general, according to Vieira Neto\textsuperscript{44}. “The stock market-clearing models answered for, in the last years, an average of 96% of every derivatives negotiation in Brazil”.

Differently from the United States, in Brazil the majority of the operations with derivatives are implemented at the stock market, which translates into a greater transparency and control of the operations, which is exactly what the American regulation is attempting with the mandatory migration of the swaps operations to the special negotiation platforms or stock market and to settlement systems via Clearing Houses, as described above. In relation to the over-the-counter derivatives market, BM\&FBOVESPA has in place swaps negotiation systems with settlement of derivatives via Clearing House, making possible to the parties negotiate over-the-counter derivatives via an electronic negotiation system\textsuperscript{45}.

It has been verified that the Brazilian experience with derivatives operations by the means of Clearing Houses occurred before the passing of Dodd Frank, which should be taken into consideration when foreign rules emerge and might cause overlapping or duplication of obligations related to business and institutions that operate here. I give special attention to those that enter into contracts with counterparties that are American, branches, subsidiaries or are under the control of an

\textsuperscript{41} Revoked. In its place currently is valid Resolution CMN 3.505/07.
\textsuperscript{42} Insertion of paragraph 4 of article 2 of Law 6385/76 as function of Law 12.543/2011.
\textsuperscript{43} Examples: Deliberation 550/08 and ICVM 475/08, which dealt with the disclosure of information related to over-the-counter derivatives operations in explanatory notes (swaps, futures and forward operations are included).
\textsuperscript{44} According to VIEIRA NETO (2010, p. 290).

institution considered American by the rules of CFTC/SEC\textsuperscript{46} and that will be subject to Brazilian rules and, simultaneously, might have to observe Dodd Frank regulations as well.

This way, several questions emerge (in addition to others that will still arise). Although the questions are simple, the answers will not be trivial, such as: (i) what rule needs to be followed in over-the-counter derivatives operations where one counterparty is Brazilian and the other one is American, in accordance to Dodd Frank and CFTC/SEC regulations? (ii) is it possible to observe the directives of Brazilian record keeping and, for this reason, disregard the provisions about the same matter discussed by Dodd Frank Act? (iii) In which way swap contracts must regulate the deposits and the management of guarantees between the parties, considering the new provisions of the Dodd Frank Act about the margin deposit in non-settled operations via Clearing Houses? (iv) how the players of the market will be able to allocate specific risks of their operations, considering that earlier they were resolved by the means of over-the-counter derivatives contracts with special clauses, having to buy or sell standardized swap contracts in the stock market, which might not satisfactory meet their needs?

In view of its unprecedented and recent character, the alterations proposed by the Dodd Frank Act, when compared to the rules and of other countries, for example, Brazil and the countries of the European Union, raise these and other questions by investors, scholars, banks, self-regulators, Brazilian regulators (including Americans), as well as multi-lateral organizations. Therefore, in the next item I will describe and attempt to analyze the most recent considerations of some scholars and market professionals about the extraterritorial impacts of the Dodd Frank Act on the Brazilian jurisdiction.

\textsuperscript{46} Definitions about the American counterparty is provided by the SEC and CFTC regulations (rule 41213) – SEC-CFTC, Cross Border Application of Certain Swaps Provisions of the Commodity Exchange Act 2012 (still in the process of final preparation by SEC and CFTC). \textbf{US Person}: (i)individual: a) individual residing in the USA; or b) who holds an individual account whose owner is an American counterparty; and (ii) entities: a) legal organized or incorporated entity under the laws of the USA; b)legal entity whose main whose main place of business is the USA; c)pension plans of a legal entity chose principal place of business is the USA; d) legal entity whose direct or indirect owners (at least one American counterparty), are responsible for their obligations; e) subsidiary, branch or office of one American counterparty established outside the USA borders; and f) conduit whose majority ownership is, directly or indirectly, an American counterparty or is operated by a commodity pool operator. (conduit: Commodity Pool – Shared Account or Collective Investment Channel).
3 Over-the-counter Derivatives and the Extraterritorial Reach of Title VII of the Dodd Frank Act

According to the Financial Times of 07.11. 2013\textsuperscript{47}, as result of the regulation to the over-the-counter derivatives market promoted by the Dodd Frank Act, the European Commission and the CFTC entered into an unprecedented agreement for international cooperation and regulation of the derivatives market, with the purpose to prevent the overlapping of norms and the rupture of global markets. This agreement between the European and American regulators demonstrate in an unmistaken way the extraterritorial reach that devices regulating the over-the-counter derivatives market in the Dodd Frank have.

Indeed, American legislators themselves established in the law, in its title VII, Section 3.150, that CFTC, SEC and the other prudential regulators, according to the definitions set forth in the American legislation\textsuperscript{48}, must consult and coordinate – with foreign regulators – in an effort to set international regulatory standards in association to the negotiation of swaps and security-based swaps. Furthermore, still according to Dodd Frank, CFTC and SEC must make efforts to enter into agreements for international cooperation and exchange information in order to reach with regulators from other countries a regulatory harmonization that is possible in the scope of the over-the-counter derivatives market\textsuperscript{49}.

As far as Brazil is concerned, the concern about the extraterritorial aspect of the provisions contained in Title VII of the Dodd Frank Act became legitimate, considering that, although is still small when compared to the American and European markets, the Brazilian financial and capital markets have several institutions and foreign investors acting as Brazilian counterparties that are involved with business directly associated to our markets, be it through the stock market or over-the-counter market or only by the means of swap bilateral contracts or international derivatives\textsuperscript{50} celebrated between companies or between financial institutions.

Consequently, the over-the-counter derivatives market, which is inserted in this international market and is composed by financial institutions that are essentially Brazilian, is also represented by American banks, its branches and subsidiaries and also European ones, what exposes our derivative markets to the international arena, having the potential to subject the Brazilian counterparties to the rules set forth by Title VII of the Dodd Frank Act, that deals with the over-the-counter derivative


\textsuperscript{48} According to CEA Section 1(a) (39).

\textsuperscript{49} According to CCH ATTORNEY-EDITOR STAFF (2010. p. 306 – International Harmonization, Section 3.150).

\textsuperscript{50} According to Contratos de derivativos de balcão firmados sob as regras e contratos padrões da International Swaps and Derivatives Association – ISDA. Available at: \texttt{<http://www2.isda.org/>}.  

market. This connection with the Dodd Frank regulations basically happens as result of operations performed with counterparties qualified as US Persons\textsuperscript{51} or still, transactions with Swap Entities, defined by Dodd Frank as Swap Dealers or Major Swap Participants\textsuperscript{52}.

In a general, and in a very simplified way, based on the technical definitions related to Swap Entities, the American counterparties are, among others, investment funds, pension funds, companies and financial institutions located in Brazil, but that have branches, subsidiaries or yet, entities controlled, directly or indirectly by companies, financial institutions or individuals considered as Americans (US Persons) in accordance to the regulations of Dodd Frank and SEC/CFTC.

BAXTER\textsuperscript{53} helps us to describe a typical situation in the international financial market, with representativity in in Brazil, particularly the one described in item B below:

A) “Rules imposed by Nation A on Global Bank X, headquartered in Nation A, constrain the operations of Global Bank X in other countries, irrespective of the rules of those other countries, unless Nation A explicitly states that its rules do not apply to actions by Global Bank X in other countries even if these actions have implications for the operations in Nation A.”

\textsuperscript{51} According to SEC-CFTC, US Persons can be characterized as: (i) individual: a) individual residing in the USA; or b) who holds an individual account whose owner is an American counterparty; and (ii) entities: a) legal entity organized or incorporated under the laws of the USA; b) legal entity whose main whose main place of business is the USA; c) pension plans of a legal entity whose principal place of business is the USA; d) legal entity whose direct or indirect owners (at least one American counterparty), are responsible for their obligations; e) subsidiary, branch or office of one American counterparty established outside the USA borders; and f) conduit whose majority ownership is, directly or indirectly, an American counterparty or is operated by a commodity pool operator. (conduit: Commodity Pool – Shared Account or Collective Investment Channel). Source: regulations of the SEC and CFTC (rule 41213) – SEC-CFTC, Cross Border Application of Certain Swaps Provisions of the Commodity Exchange Act (still in the process of being drafted by SEC and CFTC). Still in phase of final definition by American agencies.

\textsuperscript{52} According to the rules of SEC and CFTC and based on the ANBIMA Report, Number 3, 2012:

\begin{table}[h]
\begin{tabular}{|c|c|c|}
\hline
\textbf{Agents} & \textbf{Threshold} & \textbf{Regulation} \\
\hline
Swap Dealers & Frequently negotiate derivatives or act as maker of this market. & SEC-CFTC; 77 FR 30596 \\
& Minimal Threshold: national amount of US$ 8 billion, accrued in 12 months, in business with American counterparties (dealing activity). & \\
Major Swap Participants & Test 1: average daily exposure without coverage per collateral totals more than US$1 billion of dollars, in general, or US$3 billion, in interest rate derivatives? & \\
& Test 2: average daily exposure without coverage per collateral plus potential future exposition of the institution exceeds US$2 billion, in general, or US$6 billion, in interest rates derivatives? & \\
\hline
\end{tabular}
\end{table}

Source: Radar Anbima – Regulação Internacional. Year 1 – Number 3, 3\textsuperscript{rd} Quarter, 2012, based on Rule 30596 SEC-CFTC.

Observation: Companies or institutions falling under definitions set forth by SEC/CFTC must be registered as such before the referred American agencies – SEC/CFTC. It is important to point out that these definitions are not final and that SEC/CFTC still can issue new definitions.

\textsuperscript{53} BAXTER (2012, p. 5).
B) “Rules imposed by Nation A on Global Bank Y, headquartered in Nation B, will have extraterritorial effect even if they are stated to apply solely to the operations of Bank Y in Nation A, if the operations of Bank Y are actually integrated across borders.” (G.N.).

We add to these case scenarios: (i) the possibility that other countries also will issue or promulgate norms with extraterritorial reach. In this case, what norm should be applied in reference to the recording of a swap operation, for instance? (ii) the celebration of a swap contract between a bank based in the United States and a Brazilian bank (with Brazilian headquarters and control), where both have to deposit a margin at a Clearing House or another bank, what rule must a Brazilian bank follow in reference to the margin deposit? The Dodd Frank Act, Brazilian law, or both? What norm will be applied to this contract? or (iii) a subsidiary, branch or still a bank controlled by a financial institution domiciled in Brazil that enters into a swap contract with a Brazilian bank, whose settlement will occur at Euroclear based in Belgium. What norm would be applied in reference to the requirement for a prior record of the operation? Who should record this operation and under what regulation? Would the record be made at CFTC, so that the Brazilian bank might be in compliance with Dodd Frank or at a Brazilian Clearing House only? Must this Clearing House be previously approved by CFTC?

These problems and questions multiply, even for the reason that CFTC and SEC, for instance, are still working in the final definitions for the concepts of a US Person to be applied by the Dodd Frank Act, Swap Dealer and Major Swap Participant. Furthermore, CFTC and SEC can set, for instance, different concepts for US Person.

The problems at hand allow us to glance at the reasons that took CFTC and the European Commission to enter recently into an agreement for the harmonization of regulations related to over-the-counter derivatives market. According to BAXTER, the regulatory proposals of the Dodd Frank Act, like described in item 2, will have a direct extraterritorial effect over all the cases somehow involving an American institution. One of the exceptions will occur when, for instance, two institutions entering into a swap contract are not controlled or do not have any corporate connection with companies, funds, banks or

---


55 According to: CFTC divulges requirements for liquidation in CCP and new information for foreign financial institutions. *Radar ANBIMA*, Year 1, Number 4, 4th Quarter, 2012.
American institutions and only when the operation takes place outside the American territory.\\(^{56}\)

It is observed that there is a kind of regulatory contamination if an American financial institution is organized by the means of branches or subsidiaries with a global reach. All the entities of a financial conglomerate can be affected and subject to the restrictions of Dodd Frank, even if the operation or the swap contract has been fully entered into outside the borders of the United States.\\(^{57}\)

Greene sustains that the regulations emerged from the Dodd Frank Act in association to the derivatives market have extraterritorial reach – beyond the borders of the United States. He gives as example an operation involving JP Morgan Bank domiciled in the United Kingdom and a British entity. The rules also apply to them. Financial institutions are subject to local rules and to the norms of Title VII. On the other hand, the institutions that have activities that are strictly local need to observe only local rules about derivatives, whilst banks, such as a subsidiary of Deutsche Bank located in the United States, will be affected by a duplication of norms (German and the American).\\(^{58}\)

3.1 Effects of the Extraterritoriality of the Dodd Frank Act over the Derivatives Market and Participants of the Market / Difficulties and Solutions

3.1.1 Loss of Competitiveness of American Institutions

It is impossible to narrate the eventual and potential negative impacts to the Brazilian derivative market and, consequently, to the capital market, and assess the effects of the extraterritoriality of Dodd Frank only from a Brazilian viewpoint. The loss of competitiveness of the financial American institutions, for instance, can be one of its most relevant factors. According to democrat and republican leaders in the United States, Dodd Frank regulations need to be revised in view of the global reach of the norm and inability of the American economy to recover.\\(^{59}\) Admati complements that the costs imposed by Dodd Frank will be

---

56 Ibidem, p. 18. According to Baxter in his paper presented at the Finances Institute of South Korea in a joint project with Duke University Law School – United States.
58 According to GREENE and POTIHA (2012).
excessive as financial institutions will attempt to comply with the new regulations\textsuperscript{60}, affecting the competitiveness of American banks.

In accordance to the Intelligence Unit Report of the magazine \textit{The Economist}\textsuperscript{61}, American financial institutions and their European subsidiaries will lose competitiveness, capability for loans and clients with the regulations associated to the requirements for the settlement of derivative operations at Clearing systems. Still according to the mentioned report, this loss of competitiveness would be associated to the regulatory arbitration, where potential investors and foreign counterparties would refrain from making operations with derivatives involving American institutions. It is verified that the competitiveness of American banks could be the first victim of extraterritorial action of Dodd Frank.

The new law sets forth that only American dollars, bonds from the American treasury or agencies of the government (example: \textit{Federal Farm Credit Bank}), can be accepted by American and foreign Clearing Houses in operations with over-the-counter derivatives, limiting the type of guarantee that is eligible to be deposited at Clearing Houses. This way, foreign counterparties that are not American would prefer to enter into swap contracts with other institutions that would accept bonds or securities issued by local governments (for example: Brazilian clearing houses accepts bonds from the Brazilian government)\textsuperscript{62}.

Brazilian banks could not use the Brazilian Clearing Houses, being required to deposit guarantees in an American Clearing House in an international deal involving over-the-counter derivatives.

\begin{center}
\textbf{3.1.2 Duplicated and Overlapping Regulations}
\end{center}

Another problem that emerged as result of the extraterritorial character of Dodd Frank in the over-the-counter derivatives market would be the duplication or overlapping of norms in several jurisdictions with regulatory framework similar to what is proposed by Title VII of Dodd Frank. According to Brummer\textsuperscript{63}:

\textsuperscript{60} Ibidem. According to professor Anat Admati from the Business School of Stanford University.

\textsuperscript{61} According to \textit{Report from The Economist - Compliance and Competitiveness - A report from the Economist Intelligence Unit}, Sponsored by Sybase. Available at: \url{http://graphics.eiu.com/upload/eb/EIU_Sybase_FS_regulation_Web_June_16.pdf}.

\textsuperscript{62} According to GREENE and POTIHA (2012, p. 300).

Duplication risk, or even worse overlapping regulatory hurdles and compliance regimes materialize in the extraterritorial application of the derivatives space.

Greene clarifies that as result of the extraterritorial reach of the regulation, American and foreign institutions would face problems associated to conflict of norms in relation to the applicability of the Dodd Frank regulations and local rules about margin deposits. According to him:

This risk is known as duplication risk, which results in inefficiency, significant burdens for Market actors and potential regulatory arbitrage to evade the most restrictive requirements⁶⁴ (our emphasis).

### 3.1.3 Regulatory Arbitration

The inconsistency of rules or the conflict between them in the derivatives market can result in regulatory arbitrage and the migration of financial institutions to other jurisdiction that are more flexible on a regulatory level. According to scholars and specialists from American and Brazilian financial and capital markets, the variety and the quantity of rules that would begin governing the derivative markets of the United States and the European Union in view of the extraterritoriality of Dodd Frank would affect the structure and the operations of international financial institutions and the inconsistency, the conflict of norms, their overlapping, which could lead to the growth of regulatory arbitrage, lead to uncertainty and to the isolation of American Institutions in the international derivatives market.⁶⁵

Greene adds that regulatory arbitrage is a consequence of inconsistent international regulation:

Another inherent effect of inconsistent regulation, especially where one set of regulations is much more lax than another, is regulatory arbitrage; business is driven away from the stricter jurisdiction⁶⁶.

It can be concluded that, in the absence of a future regulatory harmonization of the major international markets, the objectives of Dodd Frank with the purpose to curtail systemic risk and promote transparency and the control of over-the-counter derivatives market will be

---

⁶⁴ Ibidem, p. 302.
⁶⁶ Ibidem, p. 301.
damaged. As a matter of fact, this was already a matter of concern from American legislators when Dodd Frank was being drafted, for according to this rule\textsuperscript{67}, American authorities can veto the participation of foreign institutions in the swap market of the United State if it originates, is based or headquartered in a country whose regulatory framework is not similar to the American as far as the derivatives market is concerned. What is the intention of the rule in this case? To somehow force the country of origin to adopt rules similar to those set forth by Dodd Frank, with the intention to reduce the difference of regulatory structures and the consequently decrease or eliminate a potential regulatory arbitration to be enforced by financial institutions in the international over-the-counter derivatives market\textsuperscript{68}.

3.2 Brazilian Derivative Market

In view of the negative consequences that the extraterritorial character of the Dodd Frank Act can bring to American financial institutions and, along the same lines, to the American economy, it is important to evaluate what this potential scenario of recrudescence of regulatory uncertainties can bring to Brazil.

Firstly, when observing the features of the Brazilian regulatory framework referring to the derivatives markets, one notices that Brazil already has had in place – for at least more than a decade – a legal system that is very similar to what Dodd Frank wants to put into practice. However, in view of conceptual vagueness and regulatory adjustments by the American agencies – CFTC and SEC – the Brazilian financial institutions and the branches and subsidiaries of American institutions still have to handle several uncertainties about the applicability of the rule.

Generally, scholars and specialists of Brazilian and American financial and capital markets understand that – in reference to the derivatives market – Brazil has a legal regime that, in view of the jurisdiction of its regulators, inspires confidence and transparency and has much to teach to developed countries, such as the United States, for instance. They highlight and praise the requirement for a previous notification and the mandatory recording of all operations with derivatives – be them in the stock market or over-the-counter – performed by economic agents that are subject to the Brazilian jurisdiction, so that the recording entities in Brazil might provide reliable and detailed information to their regulatory agencies, such as CVM and BACEN\textsuperscript{69}.

\textsuperscript{67} Section 173 of Dodd Frank (access to U.S. financial markets); Section 715 of Dodd Frank (prohibition on swaps trader’s entry).

\textsuperscript{68} According to SKEEL (2011, p. 184).

Other specialists and scholars also understand that Brazilian regulators are correct to demand a pre-approval of the derivatives contracts or products associated to them, especially in view of the little sophistication of the potential users of derivatives and to the risks that they might be exposed to, as for instance, those that resulted the American subprime\textsuperscript{70}.

Finally, specialists also acknowledge\textsuperscript{71} as an advantage of the Brazilian market the fact that the majority of the derivatives contracts already are standardized and negotiated in stock markets and settled in Clearing systems, be them stock markets or over-the-counter (no guarantee from a Clearing House)\textsuperscript{72}.

However, it is also observed that the eventual inexistence of a mutual recognition of regulatory regimes or still the application of the substituted compliance\textsuperscript{73} in dealings between CFTC/SEC and CVM or the lack of international cooperation by the means of bi-lateral agreements between these authorities or by the means of multi-lateral agreements via IOSCO, will cause a negative impact to the Brazilian market of derivatives, especially in the liquidity of the hedge market\textsuperscript{74} and in the capacity for the Brazilian market to provide to international investors negotiation and settlement systems for local derivatives, considering that in order for Brazilian Clearing Houses to be considered for operations performed under the Dodd Frank regime, they must be previously evaluated and registered at the CFTC/SEC\textsuperscript{75}.

However, it is important to point out that the concepts of mutual recognition and substituted compliance vary according to the regulatory agency (SEC or CFTC),

\textsuperscript{70} Ibidem.
\textsuperscript{71} Ibidem.
\textsuperscript{73} Mutual Recognition: Ibidem, p. 309. According to GREENE: “[…] mutual recognition, which is based on comparability of regulatory approaches and cooperation agreements in place among regulators. For mutual recognition, there has to be a strong conviction that if the activities permitted outside the home country are not regulated to the same degree, that there would be no contagion effect in the home country if there is a failure of an institution”. Substituted Compliance: Possibility for exception to the set of regulatory requirements derived from Dodd Frank. According to the Attachment to the Anbima Report (Radar), Year 1, Number 3, 3rd Quarter, 2012: “The possibility of exception to this set of requirements is considered through the substituted compliance process, which defines the conditions for the legislation, and resulting requirements, of other jurisdictions, be regarded as sufficient to guarantee the systemic stability associated to this market, not jeopardizing the same stability in the American environment” (our emphasis). Observation: The final definitions and concepts about these institutes are still in the process to be definitely conceptualized by CFTC and SEC. Thus, new concepts about what comes to be Mutual Recognition and Substituted Compliance might emerge after the drafting of this document.
\textsuperscript{75} CFTC has temporarily exempted from the previous registration JSCC and SGX-DC, respectively, which are Clearing Houses from Japanese and Singapore markets, by the means of drafting of Non-Action Letters. According to ANBIMMA Report (Radar), Year 1, Number 4, 4th Quarter, 2012.
understanding that these concepts are in constant change until a final definition about them will be decided by these agencies. This lack of well-defined concepts brings losses to the local market. Scott O’Malia, a CFTC commissioner, emphasizes that a large number of definitions for the same concept brings inconsistencies and clarity to the Dodd Frank rules, conveying uncertainty and confusion to the market actors. The ANBIMA report highlights this issue, also clarifying that Dodd Frank directly impacts Brazilian operations.

Another aspect that deserves the attention of the participants of the Brazilian market, CVM and BACEN is duplication or overlapping of rules that Brazilian banks and branches and subsidiaries of American financial institutions might have to fight against when attempting to make operations with over-the-counter derivatives. This problem has been likewise pointed out by Greene in items above. It is necessary to highlight the understanding of the Brazilian regulator in a letter addressed by CVM to SEC in 2012, where, broadly speaking, the additional regulation coming from the Dodd Frank rules and the supervision of the activities – that already are equally regulated by Brazilian legislation – of the institutions domiciled in Brazilian territory by CFTC will trigger an overlapping of rules and supervision (CFTC + CVM) that are unnecessary to the participants of the Brazilian market, which can discourage institutions that are eminently Brazilian to perform swap operations with American counterparties, impacting the liquidity of our market.

Finally, another aspect that deserves to be discussed and that might be a specific obstacle coming from the Brazilian legislation to an adaptation to Dodd Frank rules is the Banking Secrecy Law (Complementary Law 105/2001). As result of the restrictions set forth in Brazilian law, participants of the Brazilian market might be forbidden to provide detailed information about their operations to the CFTC in the case of previous notification and recording of swap operations, like Dodd Frank requires.

---

76 According to ANBIMA Report (Radar), Year 1, Number 4, 4th Quarter, 2012.
77 Ibidem.
79 Ibidem. It is important to remember that providing client information to third parties – including American regulators – is only possible by the means of a previous authorization from the clients of the financial institutions.
4 Final Considerations

It has been noticed that rules resulting from the Dodd Frank that have the objective to regulate over-the-counter derivatives markets are quite broad. Although details and all the alterations that these rules might cause to the American and International over-the-counter derivatives markets have not been fully analyzed, it is clear that the changes will be substantial, especially in reference to its international character and the effects that exceed the borders of the American territory and affect directly Europe, Asia, and particularly, the Brazilian market.

It just so happens that the derivatives market in Brazil, differently from American, European and Asian markets, except with a few exceptions, already has a regulatory framework and a structure that is very similar to what is proposed by Dodd Frank, what can be a facilitating element in the negotiations, whether they involve equivalence, mutual recognition or still the application of the substituted compliance. The fact remains that American legislators and regulators must look to the Brazilian market in a different way so that the participants (be them considered Americans or Brazilian) are not harmed, for instance, due to the lack of alternatives and liquidity that the duplication or the overlapping of regulations might cause to the Brazilian derivatives market.

On the other hand, the meetings held and the analysis implemented since last year by regulators, self-regulators, scholars and law professionals have contributed for a solution where the increase of controls, transparency and protection to investor will be aligned, meaning the least possible impact to the innovation and to the competitiveness of the Brazilian derivative market. Case in point is a recent Joint Decision taken by CVM and BACEN where a task force formed by servants of both institutions will have the goal to study the feasibility and the convenience in the adoption of mandatory settlement by Clearing Houses of operations performed in the derivatives market.

In addition, perhaps with positive impacts to the Brazilian market, stand out studies that are being carried out by IOSCO that pursue the cooperation and the international harmonization of the derivatives market. As the article published by Financial Times on 07/16 points out, there are different regulatory approaches for this market, so that maybe it is time

---

80 Observation: With no concern to define accurately the concept of these approaches.
for IOSCO to start setting standards and minimum recommendations with the intention to harmonize on an international level the regulatory framework of the derivatives market.\(^{83}\)

Finally, it is necessary to clarify that the objective of this paper is not to present new solutions related to the extraterritorial effects of the Dodd Frank Act, but rather to call the attention and gather the most information possible in reference to an issue that currently affects Brazilian financial institutions that might be negotiating derivatives contracts with American counterparties.

It should be remembered that it is always important to revisit and debate international characteristics of the Brazilian financial and capital markets and the rules that might affect it in a direct or potential way, and this is the objective that this paper intended to meet.

**References**


---


