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KfW Bankengruppe, Postfach 111141, 60046 Frankfurt am Main

VIA ONLINE SUBMISSION http://www.regulations.gov

Robert de V. Frierson, Secretary
Board of Governors of the Federal Reserve
Attention: Docket No. R-1415 and RIN 7100 AD74
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA45
Federal Housing Finance Agency
Eighth Floor
400 Seventh Street SW
Washington, DC 20024

Office of the Comptroller of the Currency
Attention: Docket ID OCC-2001-0008
250 E Street SW
Mail Stop 2-3
Washington, D.C. 20219

Gary K. Van Meter, Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

Robert E. Feldman, Executive Secretary
Attention: Comments RIN3064 AD-79
Federal Deposit Insurance Corporation
550 17thh Street, NW
Washington, DC 20429

››› Re: Margin and Capital Requirements for Covered Swap Entities

Date: 26/11/2012

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Ladies and Gentlemen:

We are submitting this comment letter in response to the October 2, 2012 Federal Register notice reopening the comment period for the proposed Margin and Capital Requirements for Covered Swap Entities (the "Proposed Rules") as promulgated by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency (the "Prudential Regulators"). We appreciate the opportunity to comment on the Proposed Rules, pursuant to

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

This comment letter is submitted on behalf of KfW, and the views expressed herein are those of KfW only. For the reasons described herein, we believe that the use of Swaps, as defined under Dodd-Frank, by KfW, which, as explained below, is a foreign government-linked entity owned by the Federal Republic of Germany (the "Federal Republic") and the German states and the obligations of which are backed by the full faith and credit of the Federal Republic due to a statutory guarantee, should not be subject to the regulatory scheme imposed by Dodd-Frank. Accordingly, we respectfully request that the Prudential Regulators use the authority provided by Dodd-Frank to exclude any agreement, contract or transaction a counterparty of which is KfW from the requirement to post initial and variation margin.

I. Background on KfW

Legal Status, Ownership and Statutory Guarantee

KfW is a German public law institution (*Anstalt des öffentlichen Rechts*) organized under the Law Concerning KfW (*Gesetz über die Kreditanstalt für Wiederaufbau*, or "KfW Law"). The Federal Republic holds 80% of KfW's equity capital and the German federal states hold the remaining 20%.

The KfW Law expressly provides that the Federal Republic guarantees all existing and future obligations of KfW in respect of money borrowed, bonds and notes issued and derivative transactions entered into by KfW (KfW Law, Article 1a). Under this statutory guarantee (the "Guarantee of the Federal Republic"), if KfW fails to make any payment of principal or interest or any other amount required to be paid with respect to any of KfW's obligations mentioned in the preceding sentence, the Federal Republic will be liable at all times for that payment as and when it becomes due and payable. The Federal Republic's obligation under the Guarantee of the Federal Republic ranks equally, without any preference, with all of its other present and future unsecured and unsubordinated indebtedness. Creditors who have a claim against KfW resulting from one of the obligations mentioned in the first sentence of this paragraph may enforce this obligation directly against the Federal Republic without first having to take legal action against KfW. Against this background, these obligations of KfW, both financially and in terms of legal recourse, are viewed as sovereign credits and KfW, like the Federal Republic, enjoys a triple A credit rating.

Furthermore, as a public law institution, KfW benefits from the German administrative law principle of *Anstaltslast*, according to which the Federal Republic, as the constituting body of KfW, has an obligation to safeguard KfW's economic basis. Under *Anstaltslast*, the Federal Republic must keep

KfW in a position to pursue its operations and enable it, in the event of financial difficulties, through the allocation of funds or in some other appropriate manner, to meet its obligations when due. Although *Anstaltslast* is not a formal guarantee of KfW's obligations by the Federal Republic, the effect of this legal principle is that KfW's obligations are fully backed by the credit of the Federal Republic on this basis as well, in addition to the Guarantee of the Federal Republic referred to above.

Purpose

KfW was established in 1948 by the Administration of the Combined Economic Area, the immediate predecessor of the Federal Republic. Originally, KfW's purpose was to distribute and lend funds of the European Recovery Program (the "ERP"), which is also known as the Marshall Plan. Even today, several of KfW's programs to promote the German and European economies are supported using funds for subsidizing interest rates from the so-called "ERP Special Fund". Over the past decades, KfW has expanded and internationalized its operations. Today, KfW serves domestic and international public policy objectives of the German Federal government, primarily by engaging in various promotional lending activities.[1]

As a government-owned entity, KfW does not seek to maximize profits and is prohibited from distributing profits, which are instead allocated to statutory and special reserves.[2] KfW is also prohibited from taking deposits, conducting current account business or dealing in securities for the account of others.

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1 KfW's lending activities include: domestic financing, primarily made through commercial banks, including loans to small and medium-sized enterprises, housing-related loans, grants and financings to individuals for educational purposes, financing for infrastructure projects and global funding instruments for promotional institutes of the German federal states (*Landesförderinstitute*); export and project finance through its wholly-owned subsidiary KfW IPEX-Bank GmbH ("KfW IPEX-Bank"); and development finance for developing and transition countries, including private-sector investments in developing countries through its wholly-owned subsidiary DEG—Deutsche Investitions- und Entwicklungsgesellschaft mbH ("DEG").

2 On November 4, 2012, the committee of the German governing coalition agreed to revoke the prohibition on profit distribution by KfW, which is stipulated in the KfW Law. According to a press release of the committee of the German governing coalition, the prohibition on profit distribution shall be lifted with effect for profit generated, if any, in the 2013 fiscal year. Profits shall be kept by KfW to the extent necessary for an adequate capitalization. Any remainder shall be distributed to KfW's shareholders in proportion to their respective stakes. KfW is currently unable to predict whether and, if so, when or in what form such plans may be realized or any amendments to the KfW Law may be implemented.

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Governance and Supervision

KfW is governed by an Executive Board (*Vorstand*) and a Board of Supervisory Directors (*Verwaltungsrat*). The Executive Board is responsible for the day-to-day conduct of KfW's business and the administration of its assets. The Board of Supervisory Directors, which, among others, consists of seven Federal ministers[3], supervises the overall conduct of KfW's business and the administration of its assets.

Under the KfW Law, the Federal Ministry of Finance, in consultation with the Federal Ministry of Economics and Technology, supervises KfW and has the power to adopt all measures necessary to safeguard the compliance of KfW's business operations with applicable laws, KfW's by-laws and other regulations.

In addition to the annual audit of its financial statements, KfW, as a government-owned entity, is subject to an audit that meets the requirements of the German Budgeting and Accounting Act (*Haushaltsgrundsätzegesetz*). One of the specific aspects to be covered by this audit and the related reporting is the proper conduct of KfW's business by its management.

Funding Activities and Derivatives Transactions

KfW finances the majority of its lending activities from funds raised by it in the international financial markets. KfW issues debt instruments in various currencies, primarily the Euro and the U.S. dollar (which accounted for 50% and 29% of KfW's new capital-market funding in 2011, respectively). As of December 31, 2011 KfW's total outstanding funded debt amounted to EUR 365.0 billion. On the basis of a no-action letter issued by the SEC on September 21, 1987, KfW, in connection with global debt offerings in an aggregate amount equivalent to close to EUR 350 billion, has registered debt securities with the SEC under Schedule B of the Securities Act of 1933, which is applicable to foreign governments or political subdivisions thereof, and more than 50% of KfW's funded debt

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3 Generally, the Supervisory Board has 37 members and consists of the Federal Minister of Finance; the Federal Minister of Economics and Technology; the Federal Minister of Foreign Affairs; the Federal Minister of Food, Agriculture and Consumer Protection; the Federal Minister of Transport, Building and Urban Affairs; the Federal Minister for Economic Cooperation and Development; the Federal Minister for the Environment, Nature Conservation and Nuclear Safety; seven members appointed by the *Bundesrat*; seven members appointed by the *Bundestag*; five representatives of commercial banks; two representatives of industry; one representative each of the local municipalities, agriculture, crafts, trade and the housing industry; and four representatives of the trade unions. The representatives of the commercial banks, industry, the local municipalities, agriculture, crafts, trade, the housing industry and the trade unions are appointed by the German Federal government after consultation with their constituencies.

outstanding on December 31, 2011 consisted of debt securities sold in these global debt offerings.

KfW enters into derivatives transactions in order to manage the risks incurred by it and its wholly-owned subsidiaries KfW IPEX-Bank and DEG in connection with its financing and funding activities. Such risks are almost entirely associated with changes in interest rates and foreign exchange rates. As U.S. dollar bonds make up a significant portion of KfW's funding activities, KfW generally has large over-the-counter ("OTC") positions in derivatives hedging changes in the Euro/U.S. dollar exchange rate. Many of KfW's counterparties are dealers based in the United States. While KfW occasionally entered into single-name credit default swaps in the past in order to hedge credit risk incurred in connection with its financing activities, there are no such transactions outstanding as of the date hereof. However, at some point in the future, KfW may enter into single-name credit default swaps for hedging credit risk again, as well as enter into equity-related security based swaps for purposes of hedging equity risk related to the issuance of notes which pay-out may be linked to the performance of a single stock or a narrow basket or index of stocks. As of December 31, 2011, the total notional amount of derivatives outstanding amounted to EUR 713 billion equivalent (on a consolidated basis), of which close to 25% (by notional amount) were executed with U.S. counterparties (including non-U.S. affiliates of U.S. counterparties).

KfW enters into all of the foregoing types of transactions solely for purposes of hedging risks incurred by it and its wholly-owned subsidiaries KfW IPEX-Bank and DEG, and KfW does not and, in accordance with Article 2 paragraph 3 of the KfW Law, may not, engage in proprietary or speculative trading. Further, KfW does not accommodate demand for swaps from other parties nor enter into swaps in response to interest expressed by other parties in the manner a dealer would customarily do, except that, in the context of centralizing and aggregating market-facing hedging activities within the group at the parent level, KfW accommodates demand for swaps by its wholly-owned subsidiaries KfW IPEX-Bank and DEG for their hedging activities. KfW therefore considers itself as an end-user customer of derivatives.

All of KfW's OTC derivatives transactions are concluded under appropriate derivatives master agreements (such as the ISDA Master Agreement and the German Master Agreement for Financial Derivatives Transactions). As part of KfW's risk policy, KfW's exposures under such derivatives master agreements generally are to be collateralized by KfW's counterparties. While KfW receives collateral from its counterparties under credit support annexes pertaining to the respective derivatives master agreement, it generally does not provide collateral itself for purposes of mitigating credit risk, because, as mentioned above, its obligations are backed by the Guarantee of the Federal Republic. Internal guidelines require that no transaction is executed outside such (collateralized) derivatives master agreements.

II. Treatment of Foreign Governments and KfW under certain Proposed and Final Rules issued by the Prudential Regulators and the CFTC under Title VII of Dodd-Frank

The Prudential Regulators, in their release accompanying their proposed rules on margin, noted that application of the margin requirements to foreign entities potentially raises a number of issues. First, they noted that transactions effected wholly outside the United States are outside the jurisdiction of U.S. regulatory authorities. Second, U.S. margin requirements might conflict with non-U.S. requirements, placing non-U.S. entities in an untenable position. Third, the differential treatment of U.S. and non-U.S. entities raises questions of fairness and competitive equality. Therefore, the Prudential Regulators stated that the margin requirements would apply to all transactions entered into by a U.S. entity covered by the requirements, even when it transacts with a non-U.S. counterparty. In contrast, the Prudential Regulators stated that the requirements would not apply to "foreign non-cleared swaps" which are proposed to be defined as those non-cleared swaps

> with respect to which: (i) The counterparty to the foreign covered swap entity is not a company organized under the laws of the United States or any State, not a branch or office of a company organized under the laws of the United States or any State, and not a person resident in the United States; and (ii) performance of the counterparty's obligations to the foreign covered swap entity under the swap or security-based swap has not been guaranteed by an affiliate of the counterparty that is a company organized under the laws of the United States or any State, a branch of a company organized under the laws of the United States or any State, or a person resident in the United States. As a result, foreign swaps and security-based swaps would generally only include transactions where the counterparty is not organized under U.S. law or otherwise located in the United States, and no U.S. affiliate of the counterparty has guaranteed the counterparty's obligations under the transaction.[4]

In light of the objectives of the Prudential Regulators' proposed rules, and their proposed treatment of foreign non-cleared swaps, we would like to respectfully point out the manner in which the CFTC has responded to

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4 *See* Notice of Proposed Rulemaking on Margin and Capital Requirements for Covered Swap Entities 27,580-81 (April 12, 2011), http://www.gpo.gov/fdsys/pkg/FR-2011-05-11/pdf/2011-10432.pdf.

entities such as KfW and foreign entities in general. In the CFTC's release accompanying its final rules regarding the further definition of "Swap Dealer," "Major Swap Participant," and other matters, the CFTC stated that foreign governments, foreign central banks and international financial institutions should not be required to register as a Swap Dealer ("SD") or Major Swap Participant ("MSP") and it clarified that it considers KfW a foreign government for this purpose.[5] Furthermore, in its release accompanying its final rules regarding the end-user exception to clearing requirements for Swaps, the CFTC similarly stated that foreign governments, foreign central banks and international financial institutions will not be subject to the requirement under Dodd-Frank that Swap transactions be cleared through a derivatives clearing organization and it also clarified that it considers KfW a foreign government for this purpose.[6]

The CFTC has therefore recognized that foreign sovereign entities in particular should be distinguished from other non-U.S. persons and excluded from certain of the most significant regulatory requirements and that KfW should be treated as a sovereign for these purposes. In so doing, the CFTC stated that "[c]anons of statutory construction assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws" and acknowledged that "[t]here is nothing in the text or history of the swap-related provisions of Title VII to establish that Congress intended to deviate from the traditions of the international system by including foreign governments, foreign central banks and international financial institutions within the definitions of the terms "swap dealer" or "major swap participant," thereby requiring that they affirmatively register as swap dealers or major swap participants with the CFTC and be regulated as

5 *See* CFTC and the Securities and Exchange Commission, Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 Fed. Reg., 30,596, 30,692-93 (May 23, 2012). The CFTC stated that it "does not believe that foreign governments, foreign central banks and international financial institutions should be required to register as swap dealers or major swap participants." *See id.* at 36,093. In addition, in a footnote just prior to that statement, the Release stated that "[f]or this purpose, we consider that the term "foreign government" includes KfW, which is a non-profit, public sector entity responsible to and owned by the federal and state authorities in Germany, mandated to serve a public purpose, and backed by an explicit, full, statutory guarantee provided by the German federal government." *See id.* at fn. 1178.

6 *See* CFTC, End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,560 (July 19, 2012). The CFTC stated that "foreign governments, foreign central banks, and international financial institutions should not be subject to the [clearing] requirements of Section 2(h)(1) of the CEA." *See id.* at 42,562. It further stated, as it did in its release with respect to the swap dealer and MSP definition rules, that "for this purpose, the Commission considers that the term "foreign government" includes KfW, which is a non-profit, public sector entity responsible to and owned by the federal and state authorities in Germany, mandated to serve a public purpose, and backed by an explicit, full statutory guarantee provided by the German federal government." *See id.* fn 12 at 42,561.

such." Similarly, the CFTC acknowledged that "[t]here is nothing in the text or history of the swap-related provisions of Title VII to establish that Congress intended to deviate from the traditions of the international system by subjecting foreign governments, foreign central banks and international financial institutions to the clearing requirement set forth in Section 2(h)(1) of the CEA."

In light of the arguments brought forward by the CFTC as quoted in the preceding paragraphs, we believe that the CFTC should come to the same conclusion concerning the treatment of foreign governments (including KfW) with respect to the CFTC's proposed margin rules and have thus respectfully requested the CFTC to provide similar guidance on and relief with respect to the treatment of foreign governments (including KfW) in the release to its final margin rules, or provide appropriate other relief to the same effect, by submitting a comment letter dated September 7, 2012.

We further believe that the provisions in the CFTC's proposed margin rules, taken together with the CFTC's statements and reasoning in the releases accompanying the final definitions of SDs and MSPs and its final rules applicable to end-users, similarly warrant excluding foreign governments (including KfW) from the requirement to post initial and variation margin under the Prudential Regulators' rules for the very reasons stated in these releases as quoted above. Accordingly, we respectfully request that the Prudential Regulators determine that foreign governments (including KfW) be excluded from the requirement to post initial and variation margin in its finalization of the proposed rules.

III. Exception from the Proposed Margin Requirements for Entities Such as KfW

If the Prudential Regulators' regulations requiring initial and variation margin posting for Swaps and Security-Based Swaps not cleared through a registered clearing organization are adopted as currently proposed, KfW could be required to post margin in connection with its Swaps and Security-Based Swaps transactions if its counterparties are subject to the regulation of the Prudential Regulators and are registered Swap Dealers, Security-Based Swap Dealers, Major Swap Participants or Major Security-Based Swap Participants, notwithstanding KfW's limited purpose in entering into Swaps and Security-Based Swaps as outlined under I. above and despite the fact that it is backed by the full faith and credit of the Federal Republic. We do not believe that this result is warranted or appropriate, or that it will operate to reduce systemic risk or to protect market participants. To the contrary, it will serve only to increase the cost, and reduce the efficiency, of necessary hedging transactions entered into by KfW, and perhaps force it to transact primarily or exclusively with non-U.S. counterparties.

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In light of the significant losses incurred during the financial crisis, particularly in connection with un-cleared Swaps and Security-Based Swaps, Dodd-Frank enacted Sections 731 and 764 to account for the need to address the added risk posed by Swaps and Security-Based Swaps that are not cleared through a clearing house and require the Prudential Regulators together with the CFTC and the SEC to adopt margin requirements that are comparable. Sections 731 and 764 direct the Prudential Regulators to adopt requirements that (i) help ensure the safety and soundness of the swap entity and (ii) be appropriate for the risk associated with the non-cleared swaps and non-cleared security-based swaps held as a swap entity.

While we support the Prudential Regulators' measures to enhance the safety and soundness of, and reduce systemic risk to, the overall financial system, the proposed establishment of margin requirements for uncleared Swaps and Security-Based Swaps was prompted by the failure of profit-maximizing commercial institutions. As a not-for-profit public entity backed by the full faith and credit of the Federal Republic, KfW does not pose the type of risk to counterparties, both U.S. and non-U.S., and the wider financial system that the proposed margin requirements seek to rectify.

The Dodd-Frank amendments to the CEA require that the regulations adopted by the Prudential Regulators to address the risk caused by uncleared Swaps and Security-Based Swaps be "appropriate" for the actual risk posed. Requiring entities such as KfW to post margin on their Swap and Security-Based Swap transactions would neither be "appropriate" nor be necessary to mitigate the type of risk that the proposed margin requirements seek to rectify. An exemption from the margin requirements on uncleared Swaps and Security-Based Swaps would not be inconsistent with the principles guiding the Prudential Regulators' rulemaking and would avoid placing an unnecessary burden on KfW.

Therefore, we respectfully submit that entities such as KfW, which are not-for-profit public entities backed by the full faith and credit of a sovereign government, should not be required to post initial or variation margin on Swaps and Security-Based Swaps transactions not cleared through a clearing house.

IV. Basel Commission on Banking Supervision ("BCBS") and International Organization of Securities Commissions ("IOSCO") Working Group on Margin Requirements (the "WGMR") and Request for Relief

The CFTC and the Prudential Regulators reopened the comment period for the proposed rules on margin in order to provide interested parties an opportunity to comment concurrently on the WGMR Consultative Document on Margin Requirements for Non-Centrally-Cleared Derivatives (the "WGMR Paper") issued in July 2012 and on the proposed rules. In this regard, we

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note that the WGMR Paper provides that "BCBS and IOSCO broadly supported not applying the margin requirements in a way that would require sovereigns or central banks to either collect or post margin. Both of these views are reflected by the effective exclusion of such transactions from the scope of the margin requirements proposed in this consultative paper."[7] Based on these statements, we expect the WGMR to exclude sovereigns and sovereign-linked entities from the scope of the margin requirements in their final recommendations.

Also, the WGMR Paper in Key Principle 7 provides that "[r]egulatory regimes should interact so as to result in sufficiently consistent and non-duplicative regulatory margin requirements for non-centrally cleared derivatives across jurisdictions."[8] In this context, we note that Article 1 Paragraph 4 and 5 of the so-called European Market Infrastructure Regulation ("EMIR")[9] provides for both an exemption from the clearing obligation for standardized derivatives in accordance with Article 4 of EMIR and from certain risk mitigation techniques (including but not limited to "exchanging collateral", i.e. posting and collecting margin) in accordance with Article 11 of EMIR for sovereigns, central banks, multilateral development banks and government-guaranteed public sector entities. KfW is a public sector entity within the meaning of Article 1 Paragraph 5b) of EMIR, and is thus not subject to the clearing obligation nor the margin requirements under EMIR.

We believe that excluding entities such as KfW from the requirement to post initial and variation margin is consistent with the approach taken in the WGMR Paper with respect to margin requirements for non-centrally cleared derivatives. Further, taking into consideration the exception for government-guaranteed public sector entities from the margin requirements under EMIR, such exclusion would also be consistent with Key Principle 7 of the WGMR paper calling for consistent regulatory margin requirements for non-centrally cleared derivatives across jurisdictions and be responsive to Section 752(a) of Dodd-Frank that requires the Prudential Regulators to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation ... of swaps ..." Accordingly, we respectfully request that the Prudential Regulators confirm the exclusion of government entities (including KfW) also

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7 *See* Basel Committee on Banking Supervision, Board of the International Organization of Securities Commissions, Consultative Document, Margin Requirements for Non-Centrally-Cleared Derivatives, (July 2012), *available at* http://www.bis.org/publ/bcbs226.pdf.

8 *Id.* at 29.

9 *See* 2012 O.J. (L 201), Regulation (EU) No 648/2012 of the European Parliament and the Council of July 4, 2012 on OTC Derivatives, Central Counterparties and Trade Repositories, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF.

for the reasons presented in this section in its finalization of the proposed rules.

V. Conclusion

There is no evidence suggesting that Congress intended government-owned entities like KfW to be subject to Title VII of Dodd-Frank. KfW's derivatives transactions did not contribute to the recent financial crisis that resulted in the adoption of Dodd-Frank. Subjecting KfW and its derivative transactions to the margin requirements of Dodd-Frank could have serious adverse effects on its ability to cost-efficiently hedge the risks to which it is exposed, thereby increasing costs to its borrowers, and thus may force it to direct hedging transactions currently still concluded with U.S. counterparties to non-U.S. counterparties in the future. Moreover, imposing the margin requirements of Dodd-Frank on KfW and its derivative transactions is unnecessary for the protection of counterparties and the financial system. Finally, an exclusion for KfW from the requirement to post initial and variation margin would be in line with KfW's treatment in respect of margin requirements under EMIR, be consistent with the expected scope of the WGMR paper and adequately take into account the objective to achieve consistent international regulatory requirements in accordance with Key Principle 7 of the WGMR paper and Section 752(a) of Dodd-Frank.

Accordingly, for the reasons set forth above, KfW should not be subject to the Prudential Regulators' proposed margin regulations and, we respectfully submit, should be eligible for the relief described above.

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Thank you for your consideration of our comments and please do not hesitate to contact David J. Gilberg of Sullivan & Cromwell LLP at 212-558-4000 or gilbergd@sullcrom.com if you have questions or would find further background helpful. We have sent a copy of this letter to the Federal Ministry of Finance of Germany in its capacity as KfW's supervisory authority.

Sincerely,

KfW

Name: Dr. Lutz-Christian Funke	Name: Dr. Frank Czichowski
Title: Senior Vice President	Title: Senior Vice President and Treasurer