COUNCIL OF EUROPE DEVELOPMENT BANK
BANQUE DE DÉVELOPPEMENT DU CONSEIL DE L'EUROPE

Financial Directorate
Office of the General Counsel

9 October 2012

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
4002 Basel
Switzerland

International Organization of Securities
Commissions
C/ Oquendo 12
28006 Madrid
Spain

Re: Consultative Document on Margin Requirements for Non-Centrally-Cleared Derivatives

Ladies and Gentlemen:

We are submitting this comment letter in response to the July 2012 Consultative Document entitled Margin Requirements for Non-Centrally-Cleared derivatives ("the Consultative Document"), issued by the Working Group on Margining Requirements (the "WGMR") of the Basel Committee on Banking Supervision (the "BCBS") and the International Organization of Securities Commissions ("IOSCO"). We appreciate the opportunity to comment on the initial policy proposals of the WGMR on establishing minimum standards for margin requirements on derivatives not cleared through a central clearing organization.

This comment letter is submitted on behalf of the Council of Europe Development Bank (the "CEB") and the views expressed herein are those of the CEB only; however, we believe the positions discussed below apply to all multilateral development banks ("MDBs"). The CEB is a supranational organization formed and owned by its European sovereign member states. At its core, the mission of the CEB is to promote social development and social cohesion within Europe. Specifically, the CEB seeks to achieve these goals by financing social projects and responding to emergency situations, thereby contributing to the improvement of living conditions in the least advantaged regions of Europe. The CEB is a key financial instrument of the Council of Europe's[1] solidarity policy in Europe and an integral part of post-World War II European social development.

For the reasons described herein, we are writing to express our concern regarding the application of the WGMR's initial policy proposals, as expressed in the Consultative Document, requiring the posting of initial and variation margin on derivatives that are not

1 Founded in 1949, the Council of Europe is a 47-member international organization that works to protect human rights, pluralist democracy and the rule of law; to promote awareness and encourage the development of Europe's cultural identity and diversity; to find common solutions to the challenges facing European society; and to consolidate democratic stability in Europe by backing political, legislative and constitutional reform. Most countries in Europe are members of the Council of Europe. Only two of the 27 member states of the European Union – Austria and the United Kingdom – are members of the Council of Europe but not of the CEB.

cleared through a derivatives clearing organization (the "Margin Proposals") as they apply to MDBs, and respectfully request that the final Margin Proposals exclude institutions such as the CEB from margin requirements. We respectfully request that the WGMR exclude the CEB and other MDBs from the application of the Margin Proposals.

I. The Council of Europe Development Bank

The CEB is an MDB of which forty European states are currently members (the "Member States"). Established in 1956 by certain member states of the Council of Europe to finance social programs related to the resettlement of refugees migrating to and between European countries in the aftermath of World War II, the CEB has since expanded the scope of its activities to provide aid to victims of natural or ecological disasters, education and vocational training, health services, social housing, creation and preservation of viable jobs in small and medium-sized enterprises, improvement of living conditions in urban and rural areas, protection of the environment, preservation of historic and cultural heritage, and infrastructure for administrative and judicial public services.[2] The CEB is governed by a Governing Board and an Administrative Council, each of which is comprised of representatives appointed by each Member State.

To advance its objectives, the CEB grants or guarantees long-term loans to its Member States or to institutions approved by them. The CEB's loans and guarantees typically cover only part of the cost of any project, supplementing each borrower's own funds and credit from other sources. As of December 31, 2011, the CEB had the equivalent of approximately €12.1 billion (approximately $15.7 billion)[3] of loans outstanding.

The CEB funds its operations primarily through debt offerings in the international capital markets. As of December 31, 2011, the CEB had total outstanding funded debt (long-term debt securities, including interest payable thereon and value adjustments of debt securities hedged by derivative instruments) of €20.6 billion (approximately $26.7 billion). To protect itself from the interest rate risk and currency risk inherent in its borrowing, lending and treasury operations, the CEB uses derivatives solely as an end user for hedging purposes. Further information on the CEB can be found at our website, www.coebank.org.

II. The CEB and other MDBs Should Be Exempt From Margin Requirements Proposed Under the WGMR's Final Guidance on Uncleared Derivatives

The CEB enters into derivatives only for the purposes described above in Section I. If the guidance provided by the Margin Proposals were adopted as proposed by national regulators, the CEB, along with other MDBs, could be required to post margin on derivatives entered into with its counterparties. Such a result would reduce the efficiency, while increasing the cost of, the CEB's lending, and consequently undermine the CEB's ability to fulfill its mandate of promotion of European social programs and responding to emergency situations. The use of derivatives is essential to reducing the risk and lowering the cost of the CEB's borrowing and lending activities. The CEB would not be able to provide its current level of financing to support its mandate without its existing hedging strategy. If national regulators adopted the Margin Proposals as proposed, they would significantly affect the CEB's ability to hedge in a cost-effective manner.

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2 The CEB was established by eight Council of Europe member states pursuant to a Partial Agreement between those states, and its operations, acts and contracts are governed by the Third Protocol dated March 6, 1959 to the General Agreement on Privileges and Immunities of the Council of Europe of September 2, 1949, by its Articles of Agreement (the "Articles") as amended and by regulations issued pursuant to the Articles. The CEB falls under the supreme authority of the Council of Europe but is legally separate and financially autonomous from it.

3 All EUR/USD conversions in this document are based on exchange rates as of 12/31/2011.

We do not believe this result was the intended consequence of the Margin Proposals nor that the application of the Margin Proposals to the CEB or other MDBs would serve to reduce systemic risk or protect market participants. The CEB is a highly creditworthy institution that holds the highest possible credit rating from Standard & Poor's (AAA) and Moody's (Aaa) and the second-highest credit rating from Fitch Ratings (AA+) and poses no systemic risk to the global financial system as a result of its uncleared derivatives. As an indication of the CEB's creditworthiness, the regulatory authorities responsible for the establishment of bank capital requirements for exposure to transactions with MDBs in both the United States and Europe have assigned the CEB and other MDBs the safest possible 0% risk-weighting, indicating the lowest possible risk of a default by the CEB.[4] The BCBS has also taken the view that MDBs are highly credit-worthy institutions and has similarly assigned MDBs, including the CEB specifically, a 0% risk-weighting.[5]

Moreover, the CEB enters into derivatives solely to hedge interest rate and currency risks associated with its borrowing, lending and treasury operations—not for speculative or proprietary trading purposes. The impetus for the guidance provided by the Margin Proposals, and the financial reforms instituted by national regulators more generally, was the failure of commercial institutions which sought to maximize their profits through the speculative use of derivatives. The CEB, as a not-for-profit MDB serving the needs of the least advantaged Europeans, does not pose the type of risks to the global financial system that the Margin Proposals seek to ameliorate and its derivative transactions are not the types that were believed to have contributed to the recent financial crisis or that were sought to be addressed by the resulting legislation and regulation.

The Consultative Document expressly discussed the consensus among the BCBS and IOSCO in deciding to refrain from applying margin requirements to sovereign entities and central banks, given that derivative transactions by such entities pose little systemic risk and are already exempt from clearing requirements under most national regulatory regimes.[6] We respectfully request that similar treatment be accorded to the CEB and other MDBs, as MDBs similarly comply with the WGMR's stated reasons for the exclusion of sovereigns and central banks from margin requirements. As discussed above, the CEB poses no systemic risk to the global financial system. Furthermore, national regulators have previously recognized the unique position and role of international MDBs, and given special consideration to such MDBs when implementing financial regulatory reforms, including excluding MDBs from registration and clearing requirements. The CFTC designated MDBs as "international financial institutions" when concluding that Congress did not intend to regulate such institutions as swap dealers or major swap participants or subject them to the clearing requirement for swap transactions.[7] Additionally, the European Market Infrastructure Regulation ("EMIR") excludes the CEB and other MDBs from the clearing obligations

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4 See Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System and Federal Deposit Insurance Corporation, *Regulatory Capital Rules: Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements* (June 12, 2012) (proposing to apply a 0% risk weight to exposures to MDBs, including specifically the CEB, and emphasizing the high-credit quality of MDBs). See also Directive 2006/48/EC of the European Parliament and Council of the European Union, *Capital Requirements Directive*, Annex IV, Section 4.2 (June 30, 2006) (listing the CEB as requiring a 0% risk-weighting).

5 See BCBS, *International Convergence of Capital Measurement and Capital Standards*, note 24 (June 2006) (listing the CEB as an example of an MDB eligible for a 0% risk weight).

6 See Consultative Document, p. 9.

7 See CFTC and 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, n. 1180 (May 23, 2012); CFTC, *End User End-User Exception to the Clearing Requirement for Swaps*, 77 Fed. Reg. 42,560, 42561, n.14 (July 19, 2012).

required for transactions in standardized derivatives, including the posting and collecting of margin.[8]

In light of the foregoing, we believe that the considerations previously granted to MDBs in the implementation of U.S. and European financial regulatory reforms, in light of their unique status and purpose, together with the CEB's creditworthiness, and the purpose of its trading activity, should lead to a consistent and similar consideration with respect to the Margin Proposals. The CEB respectfully submits that it, along with other MDBs that seek to finance economic development and social programs, for the policy reasons stated above, should be excluded from the WGMR's final guidance on uncleared derivatives.

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Thank you for your consideration of our comments and please do not hesitate to contact us at jacques.mirantepere@coebank.org or jan.debel@coebank.org or David J. Gilberg of Sullivan & Cromwell LLP at 212-558-4000 or gilbergd@sullcrom.com if you have any questions or would find further background helpful.

Sincerely,

Council of Europe Development Bank

P.O.

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8 See Art. 1(5)(a) of Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012, *OTC Derivatives, Central Counterparties and Trade Repositories*, OJ L 201/1.