Европейска инвестиционна банка
Evropská investiční banka
Den Europæiske Investeringsbank
Europäische Investitionsbank
Euroopa Investeerimispank
Ευρωπαϊκή Τράπεζα Επενδύσεων
European Investment Bank
Banco Europeo de Inversiones
Banque européenne d'investissement
Banca europea per gli investimenti
Eiropas Investīciju banka
Europos investicijų bankas
Európai Beruházási Bank
Bank Ewropew ta' l-Investiment
Europese Investeringsbank
Europejski Bank Inwestycyjny
Banco Europeu de Investimento
Banca Europeană de Investiţii
Európska investičná banka
Evropska investicijska banka
Euroopan investointipankki
Europeiska investeringsbanken

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Board of the International Organization of Securities Commissions
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April 5, 2013 JU/JU CORP/FI/2013-0926/RS/sldg

Re: Margin requirements for non-centrally cleared derivatives

Ladies and Gentlemen:

The European Investment Bank (the "EIB" or the "Bank") is pleased to have the opportunity to submit this comment to the Basel Committee on Banking Supervision ("BCBS") and the International Organization of Securities Commissions ("IOSCO") in response to the request for public comment with regard to the Second Consultative Document: Margin requirements for non-centrally cleared derivatives released on February 15, 2013 by the Working Group on Margin Requirements ("WGMR") ("Document").

In addition to our first comment letter dated 28 September 2012, this letter seeks to comment on following parts of the Document:

(i) Part A, Element 2, Scope of coverage - scope of applicability,
(ii) Part A, Element 4, Eligible collateral for margin, and
(iii) Appendix B, Standardised haircut schedule.

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When reviewing the Document, we noted that:

- the WGMR suggests to exempt multilateral development banks (MDBs) that are eligible for a zero risk-weight under the Basel II capital framework[1] from the obligation to post or collect collateral;
- the list of assets eligible as collateral for margin requirement purposes proposed by the WGMR does not include securities issued by MDBs[2];
- consequently, the WGMR does not foresee any haircut for securities issued by MDBs provided/held as collateral[3].

For the reasons outlined below, we respectfully request the WGMR, to consider in its final proposal to establish minimum standards for margin requirements for non-centrally-cleared derivatives:

- with respect to Part A, Element 2 to remove the requirement of a zero risk-weight under the Basel II capital framework for MDBs ;
- with respect to Part A, Element 4 to add the securities issued by certain MDBs to the list of assets eligible as collateral for margin requirements purposes; and apply levels of haircut for securities issued by MDBs similar to the level of haircut foreseen for high-quality government and central bank securities.

I. The European Investment Bank.

A. Background.

The European Investment Bank is an autonomous public institution operating on a non-profit making basis.

The Bank, owned entirely by the Member States of the European Union (the "Member States"), is the financing institution of the EU. It was created in 1958 under the original Treaty of Rome, and remains authorized under the Treaty on European Union and the Treaty on the Functioning of the European Union, amending the Treaty of Rome. It is constituted pursuant to the Statute of the European Investment Bank (the "Statute"). The Statute, as amended, is set out in a Protocol annexed to the Treaty on the Functioning of the European Union (the "Treaty"). As an annexed Protocol, the Statue is an integral part of, and has the same legal force as, the Treaty.

The Bank's mission is to foster the balanced and steady development of a common market among Member States. To that end the Bank focuses on co-financing projects by working with banks as well as corporate and public sector project promoters in the less-developed regions of the EU. To fulfil this purpose the Bank provides financing in particular in the form of loans and guarantees for projects that foster economic cohesion and convergence, and in areas that include promotion of environmental sustainability and that provide support for sustainable, competitive and secure energy. To a more limited extent, the Bank also provides funding for certain development projects outside the EU, accounting for approximately 10% of the Bank's loan portfolio.

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[1] See footnote 11 in page 9 of the consultation.
[2] See paragraph 4.1 in page 16 of the consultation.
[3] See Appendix B in page 25 of the consultation.

B. *Ownership, Governance and Financing Activity.*

The Bank is owned entirely by the Member States. The Member States subscribe to the Bank's capital. Generally, each member's share is based on its economic weight within the EU (as expressed by gross domestic product) at the time of its accession.

Pursuant to the Statute, the Bank is governed by a 27 member Board of Governors, each of whom is designated by a Member State. They are, primarily, the Finance Ministers of the Member States. The Board of Governors approves the overall strategy of the Bank, establishes credit policy guidelines, approves the annual account and balance sheet, decides on capital increases and approves activities outside the EU. The Board of Governors also appoints the 28 members to the Board of Directors on nomination by the Member States and the European Commission. The Board of Directors has sole power to make decisions on loans, guarantees and borrowings. It is also responsible for ensuring that the Bank operates within the parameters of the Treaty and Statute.

The Board of Governors also appoints a Management Committee and a six-person Audit Committee. Thus, the Member States retain a high degree of oversight over the Bank's financial status and operations.

By Treaty and under its Statute, the Bank is to operate as a non-profit entity. Its mission is to finance sound projects (and not speculative activities), as stipulated in Article 309 (ex Article 267 TEC) of the Treaty on the Functioning of the European Union:

> *The task of the European Investment Bank shall be to contribute, by having recourse to the capital market and utilising its own resources, to the balanced and steady development of the internal market in the interest of the Union. For this purpose the Bank shall, operating on a non-profit-making basis, grant loans and give guarantees which facilitate the financing of the following projects in all sectors of the economy: (a) projects for developing less developed regions; (b) projects for modernising or converting undertakings or for developing fresh activities called for by the establishment or functioning of the internal market, where these projects are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States; (c) projects of common interest to several Member States which are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States (emphasis added).*

In addition, pursuant to the Statute, the Bank's treasury activities are not oriented toward speculative trading or the pursuit of profit. In fact, as reflected in Article 21 of the Statute "*the Bank shall not, in managing its investments, engage in any currency arbitrage* not directly required to carry out its lending operations or fulfil commitments arising out of loans raised or guarantees granted by it (emphasis added)."

C. *The Bank's Funding.*

The Bank raises capital for its financing operations primarily by issuing bonds on international capital markets. Bonds are issued in around 20 currencies, chief among them Euros, the US Dollar and British Pounds, in order to diversify and optimize funding sources. As a Treaty organisation and due to its backing by 27 sovereigns and its conservative financial management, the Bank enjoys a AAA credit rating, which allows it to obtain favorable credit terms.

D. Use of Swaps and Other Derivatives.

The Bank uses derivative instruments to hedge risks to which it is exposed. In brief, the Bank seeks to hedge risks associated with changes in interest rates and foreign exchange rates. It also uses swaps to hedge the asset and liability sides of its balance sheet (treasury investments and loans, including hedging the margin component of the expected interest payments on the loans that EIB makes), as well as broad asset liability management (the overall balance sheet). In addition, the Bank enters into short-term foreign exchange swaps in order to adjust positions in its treasury in relation to its benchmark currency, the Euro, and to cater to the demand for currencies in conjunction with loan disbursements.

All of the Bank's long-term derivative transactions are conducted in the contractual framework of appropriate ISDA Master Swap Agreements with Credit Support Annexes (or equivalent), which specify the conditions of exposure collateralization by the Bank's counterparties. Financial risk policy guidelines specify collateral management rules, and establish detailed eligibility criteria and risk limits for swap counterparties. Credit risk associated with derivatives is managed by selecting well-rated counterparties, and trading with counterparties only under collateral agreements and within risk limits.

II. Application of Proposed Margin Regulations.

A. The requirement for a zero risk-weight for MDBs (Part A, Element 2)

We appreciated that the WGMR suggests exempting central banks, sovereigns, MDBs, the Bank for International Settlements, and non-systemic, non-financial firms from the obligation to post or collect collateral. However, with respect to MDBs that exemption remains subject to the further criteria that an MDB be zero risk-weighted in accordance with the Basel II capital framework.

The Basel II capital framework foresees a zero risk-weight for exposures to MDBs if they meet the following criteria:

- very high quality long-term issuer ratings, i.e. a majority of an MDB's external assessments must be AAA;
- shareholder structure is comprised of a significant proportion of sovereigns with long-term issuer credit assessments of AA- or better, or the majority of the MDB's fund-raising are in the form of paid-in equity/capital and there is little or no leverage;
- strong shareholder support demonstrated by the amount of paid-in capital contributed by the shareholders; the amount of further capital the MDBs have the right to call, if required, to repay their liabilities; and continued capital contributions and new pledges from sovereign shareholders;
- adequate level of capital and liquidity; and,
- strict statutory lending requirements and conservative financial policies, which would include among other conditions a structured approval process, internal creditworthiness and risk concentration limits (per country, sector, and individual exposure and credit category), large exposures approval by the board or a committee of the board, fixed repayment

schedules, effective monitoring of use of proceeds, status review process, and rigorous assessment of risk and provisioning to loan loss reserve.

EIB is included in the list of MDBs meeting those criteria[4]. The reference to minimum external ratings requirements (for both MDBs and their shareholders) may be restrictive and subjective since the external ratings only represent the opinion of a limited group. The mechanical application of the rating criteria may result in an obligation of the MDBs to post or collect collateral in case the external rating of them or any of their shareholders for whatever reasons is downgraded.

In EIB's opinion a possible alternative could be to remove the reference to external ratings in establishing the "zero risk-weight requirements" as set out in the Basel II capital framework (footnote 11 in page 9) and instead include an explicit list of MDBs that are exempt from posting or collecting collateral in the final proposal that are regarded as a low risk exposure. In preparing such list the WGMR could take the list currently foreseen in the Basel II capital framework[5] as a reference point.

The proposed approach aligns the treatment of the MDBs with the treatment of their shareholders. No external rating requirements are proposed for sovereigns – the main shareholders of MDBs – to decide whether they are subject to margin requirements. The proposed approach is also in line with the treatment of the Bank for International Settlements and the central banks, as no external rating requirements are proposed for these entities.

In the context of the implementation of the Basel III proposals some jurisdictions consider applying such an approach and forego the requirement of a minimum external rating to qualify an exposure as low risk. In the United States, the EIB receives treatment in line with its low risk profile. The Federal Reserve Board in its proposed Regulatory Capital Rules[6], issued on 7 June 2012, applies a zero percent risk-weight to exposures to certain named/listed MDBs, including EIB.

The draft Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRDIV), implementing the Basel III proposals in the European Union, also apply a zero percent risk-weight to exposures to certain named/listed MDBs, including EIB[7].

EIB's high credit standing is also recognised by the following statement issued by the Office of the Comptroller of the Currency (Treasury), the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation:

> *"The agencies believe this treatment [0% risk weight] is appropriate in light of the generally high-credit quality of MDBs [including EIB], their strong*

[4] See footnote 24 of paragraph 59 in Basel II : International Convergence of Capital Measurement and Capital Standards : A Revised Framework, http://www.bis.org/publ/bcbs128b.pdf.

[5] See footnote 24 of paragraph 59 in Basel II : International Convergence of Capital Measurement and Capital Standards : A Revised Framework, http://www.bis.org/publ/bcbs128b.pdf. This approach has also been used by the U.S. Commodity Futures Trading Commission to exempt the EIB from its swap clearing requirements, as well as its definitions of "swap dealer" and "major swap participant". *See* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 Fed. Reg. 30596, 30692 n. 1180 (May 23, 2012) (Joint Final Rule); End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42560, 42561-62 n.14 (July 19, 2012) (Final Rule).

[6] Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements - http://www.fdic.gov/news/board/2012/2012-06-12_notice_dis-d.pdf.

[7] See in particular Article 112 (paragraph 2) of the draft CRR (Version, 26 March 2013) - http://register.consilium.europa.eu/pdf/en/13/st07/st07747.en13.pdf

shareholder support, and a shareholder structure comprised of a significant proportion of sovereign entities with strong creditworthiness."[8]

B. Securities issued by MDBs as eligible collateral and applied haircut

In Part A, Element 4 of the Document EIB noted that the WGMR decided not to include debt instruments issued by MDBs as eligible collateral[9].

That approach does not consider all aspects of the work undertaken by the BCBS to define high-quality liquid assets (HQLA) for the purpose of calculating the liquidity coverage ratio in the Basel III framework[10], which provides a basis to assess assets as to their use in situations of stress. Assets provided as collateral for margin purposes are to be used in similar situations. These assets should allow a monetisation of their inherent value with as little depreciation due to market circumstance or the particular assessment of the creditworthiness of any counterparty as possible.

In EIB's view the criteria applied to select HQLA for the purpose of the liquidity cover ratio should also be applied in selecting the assets eligible to be used as collateral for margin requirements. In this respect EIB would like to point out that bonds issued by EIB meet the requirements to be defined as HQLA Level 1 (see analysis below). Furthermore, given that the WGMR proposes to include a broader set of eligible collateral, such as equity securities and corporate bonds, defined as HQLA Level 2, qualifying HQLA Level 1 assets (such as debt instruments issued by MDBs) as eligible collateral for margin requirements purposes is relevant and appropriate.

The acknowledgement of EIB bonds as highly liquid assets is also reflected by the fact that they are accepted as eligible collateral for refinancing operations with some of the largest central banks.

We respectfully believe that EIB bonds meet all the features of HQLA Level 1, as defined by the Basel Committee.

First, exposures to EIB have a zero percent-risk weight based on the Basel II capital framework[11]. This is also the case in the last version of the CRR[12] (under European rules) and in the proposed Regulatory Capital Rules (in the United States)[13], issued on 7 June 2012, in which the Federal Reserve Board considered EIB as an MDB and proposed to apply a 0% risk weight to exposures to MDBs.

Second, EIB bonds are eligible collateral with the largest central banks for refinancing operations, including the following:

- The Federal Reserve;

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[8] *See* Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements - http://www.fdic.gov/news/board/2012/2012-06-12_notice_dis-d.pdf.

[9] See paragraph 4.1 in page 16 of the consultation.

[10] Basel III: International framework for liquidity risk measurement, standards and monitoring, Basel Committee on Banking Supervision, December 2010 (see in particular paragraphs 34 to 42).

[11] See footnote 24 of paragraph 59 in Basel II : International Convergence of Capital Measurement and Capital Standards : A Revised Framework, http://www.bis.org/publ/bcbs128b.pdf.

[12] See Article 412 paragraph 1 of the draft CRR.

[13] Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements - http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-17010.pdf.

- European Central Bank;
- The Bank of England;
- The Swiss National Bank;
- The Bank of Japan;
- The Bank of Canada;
- The Central Bank of Norway;
- The Reserve Bank of Australia;
- The Reserve Bank of New Zealand;
- The Central Bank of Sweden.

Third, EIB bonds meet the fundamental standards prescribed in Basel III:

- Low risk: EIB bonds are of high credit standing. Indeed, EIB has historically shown a strong capital adequacy ratio considerably above minimum requirements (23.1% at end 2012) and a sound asset quality (impaired loans representing less than 0.3% of total loan portfolio at end 2012); EIB also has a robust profit generation capacity (EUR 2.7 billion in 2012) and a sizeable liquidity buffer (treasury assets of EUR 73.9bn end September 2012);
- Ease and certainty of valuation: EIB bonds have standardised, homogeneous and simple structures. Most EIB bonds (94%) are "plain-vanilla" bonds, issued with a standard bullet repayment format;
- Low correlation with risky assets: EIB bonds have a low correlation with riskier assets, based on a historical correlation analysis over the period January 2008-March 2013, covering multiple periods of stress (subprime crisis, financial crisis, sovereign debt crisis);
- Listing on a developed and recognised exchange: EIB bonds are listed in the regulated market of the Luxembourg stock exchange. This is a widely recognised exchange and the largest stock exchange in Europe in terms of international bond listings.

Fourth, EIB bonds meet the market-related standards prescribed in Basel III:

- Active and sizable market: EIB is the largest supranational issuer in the market, with an annual funding programme ranging between EUR 65 and 75 billion. EIB has a well-established and frequently refreshed curve of EUR, USD and GBP benchmark transactions. EIB has a strong and well diversified investor base. The average bid-ask spread is commensurate to the high-grade MDB market and amounts to around 0.5-2 bp for on-the-run EIB benchmark issues, and to around 2-4 bp for off-the-run bonds. The trading volume in EIB bonds is very high and EIB can also count on the support of a large number of market makers;
- Low volatility: EIB bond prices have remained relatively stable, even during stressed periods.

If EIB bonds were included in the final proposal as eligible collateral of level 1 quality, EIB would propose to apply haircut levels similar to the ones applied to "high-quality government and central bank securities". Such a treatment would again align the treatment of EIB with that of its shareholders and would in the opinion of EIB create a coherent approach.

III. Conclusion.

EIB welcomes the WGMR's suggestion to exclude central banks, sovereigns, MDBs, the Bank for International Settlements, and non-systemic, non-financial firms from the definition of covered entities, for margin requirements purposes. EIB would respectfully propose to further clarify the treatment of MDBs and the potential use of bonds issued by MDBs by:

- removing the criteria of a zero risk-weight in compliance with the Basel II capital framework (footnote 11 in page 9) thereby aligning the treatment of the MDBs with that of its shareholders and to replace it in the final proposal, with an explicit list of MDBs that are not covered entities for margin requirements purposes (Part A, Element 2);
- including debt instruments issued by MDBs in the scope of eligible collateral assets, in line with the definition of HQLA in the Basel III framework (Part A, Element 4); and
- assigning a level of haircut for debt instruments issued by MDBs similar to that applied to "high-quality government and central bank securities" (Appendix B).

We thank you for this opportunity to comment. If you have any questions about the EIB or the impact of the proposed rules on its core mission, please communicate with Richard Schnopfhagen at (352) 43 79 82481 or schnopfh@eib.org or Nicola Santini at (352) 4379 88246 or n.santini@eib.org.

Respectfully submitted,

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