Response to the BCBS-IOSCO Consultative Document
"Margin requirements for non-centrally-cleared derivatives"

Dear Madam or Sir,

We would like to thank you very much for granting us the opportunity to submit this letter in response to the above mentioned BCBS-IOSCO Consultative Document ("CD") issued July 2012. We would be grateful if the following comments would be taken into due consideration.

1. Background on KfW

KfW was established in 1948 by the Administration of the Combined Economic Area, the immediate predecessor of the Federal Republic. 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%.

As a German state-owned promotional bank, KfW serves domestic and international public policy objectives of the German Federal government, primarily by engaging in various promotional lending activities. KfW's lending activities include domestic financing, primarily made through commercial banks, including, in particular, loans to small and medium-sized enterprises and housing-related loans, export and project finance through KfW's wholly-owned subsidiary KfW IPEX-Bank GmbH and development finance for developing and transition countries.

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, 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 above, 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.

KfW is a public sector entity within the meaning of Paragraph 58 of Basel II and claims on KfW may be treated as claims on the Federal Republic in accordance with Paragraph 58 of Basel II. Under European legislation implementing Basel II, KfW is similarly treated. KfW is a public sector entity as defined in Article 4 Point 18 of Directive 2006/48/EC. Exposures to KfW resulting from - *inter alia* - holdings of bonds or notes issued by KfW or derivative transactions entered into with KfW as counterparty may be treated like exposures to the Federal Republic due to the Federal Republic’s guarantee. The risk weight for these exposures to KfW is thus zero percent under the standardized approach and may be as low as zero percent under the internal ratings based approach.

Regulation (EU) No 648/2012 (the European Market Infrastructure Regulation or “EMIR”), with the exception of the reporting obligation in Article 9, does not apply to public sector entities as defined in Article 4 Point 18 of Directive 2006/48/EC where they are owned by central governments and have explicit guarantee arrangements provided by central governments. KfW is thus neither subject to the clearing obligation nor the margin requirements under EMIR.

2. Comments on Q11 of the Consultative Document

Q11: “Are the proposed exemptions from the margin requirements for non-financial entities that are not systemically important, sovereigns, and/or central banks appropriate?”

In relation to question number 11, we note the following:

No. 2 of the key principles and proposed requirements of the CD deals with the scope of applicability of the requirements. For these purposes, “covered entities” are proposed to be “all financial firms and systemically important non-financial entities that engage in non-centrally-cleared derivatives.”

We fully agree with BCBS-IOSCO’s approach that the margin requirements need not apply to non-centrally-cleared derivatives to which non-financial entities that are not systemically-important are a party, given that (i) such transactions are viewed as posing little or no systemic risk and (ii) such transactions are exempt from central clearing mandates under most national regimes. In fact, (ii) is the natural consequence of (i) in our view.

We also fully agree with the statement in footnote 7 of the CD that "[e]nsuring consistency between entities that are subject to the central clearing obligation for standardised derivatives and those entities that are subject to margin requirements for non-centrally-cleared derivatives is desirable*. Requiring entities which are not subject to the central clearing obligation for standardized derivatives to post margin (in order to promote central clearing) would not be consistent in itself. This is in particular true in respect of entities the uncollateralized exposure to which may be assigned a zero risk weighting because it is considered riskless.

In this context, we would like to draw your attention to the fact that European legislators have already opted to establish under EMIR a level of consistency between the central clearing obligation for standardized derivatives and the margin requirements for non-centrally cleared derivatives as described in the preceding paragraph. Article 1 Paragraphs 4 and 5 of EMIR provide 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. Please note that for the entities listed in Article 1 Paragraphs 4 and 5 of EMIR the exemptions do not depend on whether they would be deemed financial counterparties or non-financial counterparties in accordance with the relevant definitions in EMIR if these were applicable nor whether their derivatives portfolio exceeds certain thresholds or not (generally relevant for non-financial counterparties only).

Taking into consideration the potential irrelevance of the status of certain entities that are granted broader exemptions under applicable derivatives regulation as described in the preceding paragraph with respect to EMIR, we are concerned that the wording of key principles No. 1 and No. 2 might lead to misunderstandings. We therefore kindly suggest that BSCB-IOSCO clarify in the key principles that “covered entities” shall be all entities that are subject to the central clearing obligation by amending the drafting of key principles No. 1 and 2 as follows:

Key Principle No. 1:

“Appropriate margining practices should be in place with respect to all derivatives transactions that are concluded between entities subject to the central clearing obligation but that are not cleared by CCPs.”

Key Principle No. 2:

“All financial firms and systemically important non-financial entities that are subject to the central clearing obligation for standardized derivatives ("covered entities") must exchange initial and variation margin as appropriate to the risks posed by such non-centrally-cleared derivative transactions.”

Sincerely,

KfW

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