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submitted via Email

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Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
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c/o

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**»» CSA Staff Notice 91-303 – Proposed Model Provincial Rule on
Mandatory Central Counterparty Clearing of Derivatives, dated
December 19, 2013**

Date: 18-03-2014

Ladies and Gentlemen:

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We are submitting this comment letter in response to the Staff Notice 91-303 – Proposed Model Provincial Rules on Mandatory Central Counterparty Clearing of Derivatives (the “Clearing Rule”) and Proposed Model Explanatory Guidance to the Central Counterparty Clearing Rule (the “Clearing EG”), both dated December 19, 2013 (together the “Staff Notice”), issued by the Canadian Securities Administrators (the “CSA”). We appreciate the opportunity to comment on the proposed requirements on mandatory central counterparty clearing set forth in the Clearing Rule.

This comment letter is submitted on behalf of KfW, and the views expressed herein are those of KfW only. KfW, as further explained below, is a foreign government-sponsored 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. For the reasons laid down herein, we believe that transactions with entities owned or controlled by foreign governments, such as KfW, should benefit from an exemption comparable to the exemption from the obligation to submit, or cause to be submitted, a

transaction for clearing to a clearing agency that provides clearing services for a clearable derivative, provided for under Section 11 of the Clearing Rule for Canadian federal, provincial and territorial governments, for crown corporations and entities wholly owned by the federal or provincial government whose obligations are guaranteed by the federal or provincial government (together, the "Canadian Governments"). Accordingly, we respectfully request the CSA to exempt transactions of a local counterparty concluded with KfW from the potential obligation to submit, or cause to be submitted, such transactions to a clearing agency for central clearing according to Section 4 of the Clearing Rule.

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

KfW does not seek to maximize profits. KfW does, however, seek to maintain an overall level of profitability that allows it to strengthen its equity base in order to support its promotional activities and to grow the volume of its business. KfW is prohibited under the KfW Law from distributing profits, which are instead allocated to statutory and special reserves. KfW is also prohibited from taking deposits, conducting current account business or dealing in securities for the account of others.

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 ministers², 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 (*Rechtsaufsicht*, legal supervision).

¹ KfW’s lending activities include: (i) domestic financing, primarily made via 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*), (ii) export and project finance through its wholly-owned subsidiary KfW IPEX-Bank GmbH (“*KfW IPEX-Bank*”) (iii) 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 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.

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 (*Haushaltsgrundsätze-gesetz*). 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.

KfW is not recognized or treated as a bank in accordance with Section 2(1), No. 2, of the German Banking Act (*Gesetz über das Kreditwesen*, or "*KWG*") and is exempted from European Union bank regulatory requirements in accordance with Article 2 Paragraph 5(6) of the European Banking Directive (Directive 2013/36/EU). However, amendments to the KfW Law enacted in July 2013 and implemented by a regulation published in October 2013 (the "*KfW Regulation*") subject KfW by analogy to such provisions of European and German bank regulatory law as are expressly listed in the regulation, in particular provisions of the KWG and the Regulation (EU) No. 575/2013 (Capital Requirements Regulation). The KfW Regulation also provides for supervision of KfW's compliance with the applicable provisions of bank regulatory law by the German Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*) in cooperation with the German Central Bank (*Deutsche Bundesbank*). With respect to its compliance with all other applicable law, KfW remains under the legal supervision (*Rechtsaufsicht*) of the Federal Ministry of Finance, as described above.

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 48% and 39% of KfW's new capital-market funding in 2013, respectively). As of December 31, 2012 KfW's total outstanding funded debt amounted to EUR 388.0 billion. At year-end 2012, the total outstanding of notes issued in CAD amounted to CAD 4.9 billion³.

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 own and its subsidiaries financing and funding activities. Such risks are almost entirely associated with changes in interest rates and foreign exchange rates.

Some of KfW's major counterparties are dealers based in Canada. As of January 31, 2014, the total notional amount of derivatives outstanding amounted to EUR 684 billion equivalent (on an unaudited consolidated basis), of which close to 7.4% (by notional amount) were executed with Canadian 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 centralising and aggregating market-facing hedging activities within the group at the parent level, KfW accommodates

³ No audited figures for 2013 are available yet.

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.

II. Treatment of KfW under over-the-counter derivatives regulation in the United States and Europe

Against the background of CSA's contributions to and monitoring of international regulatory proposals and legislative initiatives to develop international standards, we would like to respectfully point out the manner in which entities like KfW are treated in other jurisdictions with respect to over-the-counter derivatives regulation.

Treatment of KfW under certain rules issued by the U.S. Commodity Futures Trading Commission ("CFTC") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")

CFTC has responded to entities such as KfW and foreign entities in general. In its release accompanying its final rules regarding the end-user exception to clearing requirements for swaps, the CFTC 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 organisation and it also clarified that it considers KfW a foreign government for this purpose.⁴ Furthermore, 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 or Major Swap Participant and it clarified that it considers KfW a foreign government for this purpose.⁵

The CFTC has therefore recognised 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,

⁴ See CFTC, End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42560 (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 42562. It further stated 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 42561.

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., 30596, 30692-93 (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 36093. In addition, in a footnote just prior to that statement, the release stated that "for 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.

including the clearing requirements for swaps, and that KfW should be treated as a sovereign for these purposes.

Treatment of KfW under European legislation

With respect to the so-called European Market Infrastructure Regulation (“EMIR”)⁶, Article 1 Paragraph 5 of EMIR provides that, with the exception of the reporting obligation, EMIR shall not apply to a) multilateral development banks, b) public sector entities owned and explicitly guaranteed by a central government, and c) the European Financial Stability Facility and the European Stability Mechanism. KfW is a public sector entity within the meaning of Article 1 Paragraph 5(b) of EMIR⁷, and is thus, except for the reporting obligation, not subject to the obligations imposed by EMIR, including the clearing obligation and margin requirements.

III. Discussion of the options to exempt counterparties from the mandatory clearing requirement proposed in the Staff Notice

In general, a local counterparty to a transaction in a clearable derivative is obliged to submit such transaction for clearing to a clearing agency pursuant to Section 4.(1) of the Clearing Rule. If the transaction is submitted for clearing pursuant to the laws of foreign jurisdictions to be listed in a future appendix to the Clearing Rule, the local counterparty satisfies its duty to submit such transaction for central clearing under the Clearing Rule, Section 4.(2)(b)(ii) of the Clearing Rule. The respective appendix of foreign jurisdictions is not yet part of the Clearing Rule. If the European rules for mandatory central clearing in EMIR were considered an equivalent rule to the Clearing Rule and hence included in the aforementioned appendix, the local counterparty would fulfill its obligations to centrally clear a transaction with a European counterparty under the Clearing Rule by submitting the transactions for clearing pursuant to the rules under EMIR. As explained under II. above, KfW, however, is not required to submit its derivative transactions for central clearing under EMIR. Therefore, KfW would be required to voluntarily comply with EMIR requirements for central clearing, from which it has been expressly exempted by its home legislators, in order to enable its Canadian local counterparty to comply with the Clearing Rule.

Pursuant to Section 7.(1) of the Clearing Rule, a transaction is exempt from the mandatory central clearing requirement if (i) one of the counterparties is not a financial entity as defined in Section 1 of the

⁶ 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>.

⁷ Art. 1 Paragraph 5(b) of EMIR refers to the definition of public sector entity in point (18) of Art. 4 of Directive 2006/48/EC, the predecessor rule of the European Banking Directive (Directive 2013/36/EU). Public sector entities in Directive 2006/48/EC are defined as non-commercial administrative bodies responsible to central governments, regional governments of local authorities, or authorities that in the view of the competent authorities exercise the same responsibilities as regional and local authorities, or non-commercial undertakings owned by central governments that have explicit guarantee arrangements, and may include self administered bodies by law that are under public supervision.

Clearing Rule and (ii) the transaction is intended to hedge or mitigate commercial risk related to the operation of its business. KfW does not qualify as a financial entity within the meaning of the Clearing Rule, i.e. KfW is not a person or company organized in a foreign jurisdiction that is analogous to any of the entities referred to in Section 1.(a) to (f) of the Clearing Rule and would, therefore, not be regulated under the applicable legislation in Canada had it been organized in Canada pursuant to Section 1.(g) of the Clearing Rule. In case of being organized in Canada, from our point of view, KfW, as a public sector entity under European law⁸, would rather qualify as entity wholly owned by the federal or provincial government whose obligations are guaranteed by the federal government as described in the non-application rule of Section 11 of the Clearing Rule for Canadian Governments.

Furthermore, as described above under the caption "Funding Activities and Derivatives Transactions", KfW is an end-user of derivatives and uses derivatives solely for purposes of hedging and mitigating commercial risk related to its business operations. Hence, the end-user exemption of Section 7.(1) of the Clearing Rule would generally apply to KfW.

As an end-user of derivatives relying on the described exemption, KfW would have to keep records of all documentation (including hedging strategy and transaction based information showing that derivative transactions are solely used for hedging purposes as described in the Clearing EG) demonstrating that it is eligible to benefit from the exemption. These records need to be kept in a safe and durable manner to permit to be provided to the applicable Canadian local regulator at short notice, Section 10 of the Clearing Rule.

The authority of a Canadian local regulator to supervise KfW's documentation requirements relating to the end-user exemption of the Clearing Rule, we respectfully submit, would be unnecessary for the realization of the purposes of the intended regulation. KfW, as noted, is a wholly government-owned entity under the jurisdiction and supervision of the German Federal authorities, rendering regulation and supervision by an extraterritorial authority dispensable.

KfW is backed by a statutory guarantee of the Federal Republic and, from a credit risk perspective, its obligations rank equally with those of the Federal Republic. The Federal Republic also has an obligation to safeguard KfW in the event of financial difficulties under the administrative law principal of *Anstaltslast* as discussed above. Furthermore, KfW does not seek to maximize profits, but rather has a mandate of furthering the public policy objectives of the Federal Republic by primarily engaging in promotional lending activities. Considering the aforementioned reasons and the structure and ownership of KfW, we submit that KfW is closely aligned with sovereign entities, and is distinct from private banking or trading businesses.

Hence, KfW's position is comparable to that of the Canadian Governments as described under Section 11 of the Clearing Rule for which a general exemption from the mandatory clearing requirement is provided. Compared to Section 7 of the Clearing Rule, the non-application provision of Section 11 applies to any derivative transaction to which a Canadian

⁸ See fn. 7 above.

Government is counterparty without any further requirements. Any foreign governments or government-owned entities are not included in this rule.

For the abovementioned reasons, we think that foreign governments and government-owned entities, in particular those entities which are explicitly guaranteed by a foreign government⁹, should be treated like Canadian Governments and benefit from the abovementioned general exemption because they equally represent sovereign risk.

If a general exemption of foreign governments and government-owned entities like KfW from the Clearing Rule is not deemed to be appropriate, an individual approach to exempt certain foreign governments and government-owned entities from mandatory central clearing requirements on a case-by-case-basis should be considered as a viable alternative. Section 17 of the Clearing Rule already provides the basis for granting an exemption to the Clearing Rule on an individual basis. We respectfully suggest considering a respective indication in the Clearing EG that foreign governments and government-owned entities may request an exemption to the Clearing Rule pursuant to Section 17 of the Clearing Rule.

IV. Conclusion

In sum, based on the foregoing, we believe that derivative transactions entered into by KfW and other foreign government-owned entities should be excluded from the scope of the Clearing Rule. Due to KfW's purpose, use of derivatives, ownership structure and Guarantee of the Federal Republic, its activities will not pose a risk to Canadian financial markets. In this aspect, KfW is comparable to Canadian Governments who benefit from a general exemption from the central clearing obligation. Under such circumstances, the relief sought hereunder is appropriate and necessary.

Accordingly, we respectfully request that the CSA determine that foreign governments and entities owned or controlled by foreign governments (including KfW) to be directly excluded from the requirement to submit a transaction in a clearable derivative for clearing by a clearing agency without reverting to the end-user exemption which is the route the CFTC has taken in the U.S.

Thank you for your consideration of our comments and please do not hesitate to contact us 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 owner and in its capacity as KfW's legal supervisory authority.

Sincerely,
KfW



Name: Dr. Lutz-Christian Funke
Title: Senior Vice President



Name: Dr. Frank Czichowski
Title: Senior Vice President and Treasurer

⁹ As outlined above and under footnote 5 of this paper, the CFTC, for example, considers that the term „foreign government“ includes KfW as a non-profit, public sector entity owned and guaranteed by the Federal Republic.