

submitted via Email

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission

Anika Marsotto
Our ref.: Mao
Phone: +49 69 7431-4634
anika.marsotto@kfw.de

Date: 05-09-2016

c/o

1) Robert Blair, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8
comments@osc.gov.on.ca

2) Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22^e étage
C.P.246, Tour de la Bourse
Montréal, Québec
H4Z 1G3
consultation-en-cours@lautorite.qc.ca

»» **CSA Consultation Paper 95-401 – Margin and Collateral Requirements for Non-Centrally Cleared Derivatives, dated July 7, 2016**

Ladies and Gentlemen:

We are submitting this comment letter in response to the Consultation Paper 95-401 “Margin and Collateral Requirements for Non-Centrally Cleared Derivatives”, dated July 7, 2016 (the “CP 95-401”), issued by the Canadian Securities Administrators (the “CSA”). We appreciate the opportunity to comment on the proposed margin requirements for non-centrally cleared derivatives, in particular, on Question 8 of Part 5 (Eligible Collateral).

1. Background on KfW

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 KfW Law expressly provides that the Federal

Republic of Germany (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. 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 in the preceding sentence, the Federal Republic will be liable at all times for that payment as and when it becomes due and payable.

KfW serves domestic and international public policy objectives of the German Federal government, primarily by engaging in various promotional lending activities, including granting loans to small and medium-sized enterprises, housing-related loans 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").

KfW finances the majority of its lending activities from funds raised by it in the international financial markets and 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.

KfW is a public sector entity ("PSE") in the meaning of Article 4 Paragraph 1 point 8 of the EU Capital Requirements Regulation ("CRR").¹ In accordance with Article 116 Paragraph 4 of the CRR, exposures to a PSE in the meaning of the CRR can receive the same risk weight as exposures to the central or regional government or local authority if the competent authority in the relevant jurisdiction is of the opinion that there is no difference in risk between exposures to the PSE and exposures to the central or regional government or local authority because of the existence of an appropriate guarantee by such central

¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012. In accordance with Article 4 Paragraph 1 point 8 of the CRR, public sector entity means a non-commercial administrative body responsible to central governments, regional governments or local authorities, or to authorities that exercise the same responsibilities as regional governments and local authorities, or a non-commercial undertaking that is owned by or set up and sponsored by central governments, regional governments or local authorities, and that has explicit guarantee arrangements, and may include self-administered bodies governed by law that are under public supervision.

or regional government or local authority. In a letter dated October 18, 2013, the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* or BaFin) confirmed that there is no difference in risk between exposures to KfW and comparable exposures to the Federal Republic because of the statutory guarantee of the Federal Republic. Hence, exposures to KfW as a PSE in the meaning of the CRR can receive the same risk weight as exposures to the Federal Republic.

For further background on the status, purpose and activities of KfW, we would like to refer to our comment letter submitted on March 18, 2014 in response to the CSA Staff Notice 91-303 – Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives, dated December 19, 2013.

2. Comments on the CP 95-401

Eligible Collateral

With respect to Part 5 of the CP 95-401 (Eligible Collateral), we would like to comment on Question 8, which refers to the Guideline E-22 of the Office of the Superintendent of Financial Institutions Canada (“OSFI”) on “Margin Requirements for Non-Centrally Cleared Derivatives”, published in February 2016 (the “OSFI Guideline”), and the inclusion by OSFI of debt securities issued by PSEs treated as sovereigns by national supervisors as eligible collateral. The CSA question whether to include such securities as eligible collateral and whether there are potential risks and concerns attached to it.

As mentioned in the CP 95-401, the CSA will base their respective future regulation on the final policy framework “Margin Requirements for non-centrally cleared derivatives” developed by the Basel Committee on Banking Supervision (“BCBS”) and the International Organization of Securities Commissions (“IOSCO”), published in March 2015 (the “BCBS-IOSCO Standards”). In the BCBS-IOSCO Standards, certain characteristics of eligible collateral are defined² and a list of assets that would generally satisfy these characteristics as eligible collateral³ is included. In fact, debt securities issued by PSEs are not part of the list in the BCBS-IOSCO Standards. But as the list of eligible collateral is considered to be illustrative and explicitly not to be viewed as being exhaustive, national regulators, when implementing the BCBS-IOSCO Standards into their national regimes, should develop their own list of eligible

² These characteristics include high liquidity of the assets, strong value under stressed market conditions, low credit, market and foreign exchange risks and low correlation with the creditworthiness of the counterparty posting the collateral and with the derivatives to which the collateral is posted.

³ These assets include amongst others cash, high-quality government and central bank securities or high quality corporate bonds.

assets. They are free to add other assets and instruments that satisfy the principles set out in the BCBS-IOSCO Standards.

Beside the OSFI-Guideline applicable to federally regulated financial institutions in Canada, in Europe the draft for a Commission Delegated Regulation supplementing Regulation (EU) No 648/2012 (“EMIR”), dated July 28, 2016, (the “Draft Delegated Regulation”), following the final draft of the European Supervisory Authorities of Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11 Paragraph 15 of EMIR, dated March 8, 2016, extends the general list of eligible collateral set up in the BCBS-IOSCO Standards described above and provides in Article 4 Paragraph 1(e) of the Draft Delegated Regulation that debt securities issued by a PSE of a member state of the European Union are eligible assets for posting or collecting collateral for non-centrally cleared derivatives if the requirements of Article 116 Paragraph 4 of the CRR are fulfilled.⁴ As described under section 1 of this letter, this is the case if the competent authority in the relevant jurisdiction is of the opinion that there is no difference in risk between exposures to the PSE and exposures to the central or regional government or local authority because of the existence of an appropriate guarantee by such central or regional government or local authority.

From our point of view, the risk profile of debt securities issued by foreign PSEs is equal to the risk profile of debt securities issued by the relevant foreign government itself provided that they represent the full faith and credit of the foreign government because of the existence of an adequate guarantee or similar instrument. Therefore, if the further asset criteria as described in the BCBS-IOSCO Standards and in the CP 95-401 are fulfilled, we cannot identify any concerns with respect to the inclusion of debt securities issued by foreign PSEs that are backed by the full faith and credit of a foreign government into the catalogue of eligible assets listed in the CP 95-401.

Further, we are of the opinion that including debt securities issued by foreign PSEs that are backed by the full faith and credit of the relevant foreign government as eligible collateral would help to ensure the availability of high-quality collateral for covered entities to fulfil their respective margin requirements which is an important objective of the future rule of the CSA.

We acknowledge that OSFI’s wording of the definition with respect to debt securities issued by PSEs (“... treated as sovereigns by the national supervisor”) may potentially be too broad and leave too much discretion to the national

⁴ Likewise, debt securities issued by third countries’ PSEs are eligible collateral in accordance with Article 4 Paragraph 1k) of the Draft Delegated Regulation if the requirements of Article 116 Paragraph 4 CRR are fulfilled.

supervisor, in particular, with respect to the criteria that need to be met for a PSE to be treated as a sovereign. While it is likely that national supervisors will require some kind of support mechanism by the foreign government, such as a guarantee, to be in place in order to determine that a PSE may be treated as a sovereign, it is not clear which criteria exactly national supervisors will require to be met: an explicit or an implicit guarantee, a keep-well agreement or simply ownership by a foreign government or some other instrument or mechanism. Further, creditors may or may not have a direct claim against the foreign government under the relevant support mechanism. For example, there may be forms of keep-well agreements where only the PSE itself has a direct claim against the foreign government that it be kept solvent, but not the PSE's creditors.

Therefore, we propose that the CSA require that the debt securities issued by PSEs be guaranteed by a foreign government in order to qualify as eligible assets and suggest the following wording for the list of eligible assets, also taking into account the structure of the provision under (c) of the list of eligible assets on page 39 OSCB 6142 regarding debt securities issued or guaranteed by Canadian governments:

“(f) debt securities issued by or guaranteed by foreign governments with a rating of at least BB-; ...”

We further suggest deleting the expression in square brackets under “(f) ... [guaranteed by the revenues of those governments]” in the list of eligible assets. It is our understanding that debt securities issued by governments are usually unsecured and therefore not expressly guaranteed by revenues of those governments, even though the credit of such debt securities is factually supported by such revenues that are mostly raised from general tax receipts.

We also noticed that debt securities issued by (or guaranteed by, if the future rule of the CSA were extended as proposed by us) foreign governments are not explicitly included in the Standardized Haircut Schedule in Appendix B to the CP 95-401. We propose to include them into the Schedule by extending the scope of application of the boxes relating to debt securities issued or guaranteed by Canadian governments to debt securities issued by or guaranteed by foreign governments:

“Debt securities issued by or guaranteed by the Government of Canada or the government of a province or territory of Canada, foreign governments or the BIS, IMF ...”

Thank you very much 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: Andreas Müller
Title: Senior Vice President

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