

NBIM

Norges Bank Investment Management

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David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW.
Washington, DC 20581

OFFICE OF THE
SECRETARIAT

Date: 6 July 2011
Your ref.:
Our ref.:

COMMENT

Re: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants: RIN 3038-AC97

Dear Mr. Stawick:

Norges Bank Investment Management welcomes the opportunity to comment on the rules (the "Margin Rules") recently proposed by the Commission regarding margin requirements for uncleared swaps for swap dealers and major swap participants, implementing requirements of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Norges Bank Investment Management ("NBIM") is a division of Norges Bank, the central bank of the Kingdom of Norway.¹

In general, the Margin Rules would require swap dealers, major swap participants, and "financial entities" to post minimum amounts of initial and variation margin in connection with uncleared swaps entered into with non-bank counterparties. Those minimum amounts are required to be calculated in a manner described in the Margin Rules. Swap participants who are not swap dealers, major swap participants, or "financial entities" are not required to post specified amounts of margin, but rather are required to post amounts of initial and variation margin "that may be required pursuant to the credit support arrangement(s) between [the parties to the transaction]." By making the "government of any foreign country or a political subdivision, agency, or instrumentality thereof" a financial entity, the Margin Rules would impose on any such entity margin requirements applicable to ordinary commercial investors, and would preclude the ability of the parties to tailor margin requirements to the government entity in question and to any risks of nonperformance it might pose.

We respectfully submit that this approach does not recognize the important differences between sovereign and other governmental entities, on the one hand, and private investors,

¹ We are today submitting similar comments to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency, in respect of the rules proposed by those agencies, in *Margin and Capital Requirements for Covered Swap Entities*, 76 Fed. Reg. 27564 (May 11, 2011) (the "Bank Release").
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NBIM is the investment management division of Norges Bank - the central bank of Norway

Bankplasseen 2
P.O. Box 1179 Sentrum
NO-0107 Oslo

Tel.: + 47 24 07 30 00
Fax + 47 24 07 30 01
www.nbim.no

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on the other, and is generally inconsistent with the Congress's approach to the extra-territorial application of the Dodd-Frank Act.

Background. In its release proposing the Margin Rules (the "Proposing Release")², the Commission noted that the proposed definition of the term "financial entity" tracks the list of entities the Dodd-Frank Act inserted into Section 2(h)(7)(C) of the Commodity Exchange Act. (If no financial entity is a party to a swap, the swap may be exempt under that Section from the mandatory clearing requirement.) Importantly, however, the Commission proposes to add two types of entities to the list for purposes of the Margin Rules – entities that would be commodity pools or private funds if organized in the United States and "any government of any foreign country or any political subdivision, agency, or instrumentality thereof." In the Proposing Release, the Commission wrote:

"The Commission notes that these types of sovereign counterparties do not fit easily into the proposed rule's categories of financial and nonfinancial entities. In comparing the characteristics of sovereign counterparties with those of financial and nonfinancial entities, the Commission preliminarily believes that the financial condition of a sovereign will tend to be closely linked with the financial condition of its domestic banking system, through common effects of the business cycle on both government finances and bank losses, as well as through the safety net that many sovereigns provide to banks. Such a tight link with the health of its domestic banking system, and by extension with the broader global financial system, makes a sovereign counterparty similar to a financial entity both in the nature of the systemic risk and the risk to the safety and soundness of the covered swap entity."

In the Proposing Release, the Commission requested comment as to, among other things, whether the classification of sovereign counterparties as financial entities is appropriate in light of the risks posed by them.

Classification of sovereign counterparties. We respectfully submit that the classification of sovereign counterparties as financial entities is inappropriate for a number of reasons.

First, in the case of Norway and Norges Bank and, we believe, in the case of many if not all other developed countries, the financial condition of a sovereign nation and its central bank (and other agencies and instrumentalities) is not "closely linked" with the financial conditions of commercial banks in the country, in any manner that would justify treating those entities on an equal basis with commercial banks. Among other things, the financial resources, obligations, and dealing motivations of the two are entirely different. Sovereign nations have no customers, and typically invest for the longer term, have no public shareholder base, and have very substantial financial resources at their disposal, making them entirely different from commercial banks.

² *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 23732 (April 28, 2011).

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Second, Congress made clear throughout the Dodd-Frank Act that considerations of international comity, the nature of a home country's regulatory and oversight functions, and the specific risks posed to the swap markets by foreign entities should be considered by U.S. regulators in considering the extra-territorial reach of the Act. The Commission itself has recognized the important role "considerations of international comity play in determining the proper scope of extraterritorial application of federal statutes."³ In this case, the blanket application to foreign sovereigns, central banks, and other governmental entities of margin requirements designed in the first instance to govern dealings between commercial counterparties could well have highly negative effects on the activities of those foreign sovereigns, without any corresponding benefit through reduction of risk. For example, under the Commission's rules, many routine foreign currency transactions effected by a foreign central bank might become subject to the automatic application of the Margin Rules – a result the Congress would almost certainly have mentioned specifically in the Dodd-Frank Act if it had intended it.⁴ When the Congress defined "financial entity" in the Dodd-Frank Act, it did not include any reference to foreign sovereigns; indeed, the only element of the definition that might arguably apply to a foreign sovereign is clause (VIII) of the definition, referring to "a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature." Foreign governments are not predominantly engaged in banking or financial activities. Moreover, we understand that U.S. courts have made clear over the years that where statutes purport to regulate any "person" the term should not generally be regarded as including a sovereign entity absent an evident contrary Congressional purpose.⁵

Last, classification of foreign sovereigns and their agencies and instrumentalities as financial entities leads to unreasonable and, we expect, unintended results under the Margin Rules themselves. For example, the Margin Rules distinguish between different types of financial entities for purposes of determining whether they qualify for initial and variation margin thresholds. Qualification depends on whether a financial entity meets enumerated criteria, presumably reflecting a view that financial entities meeting those criteria present a lower level of risk than other financial entities.⁶ "However, most, if not all, of the criteria a

³ See Registration of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71379, 71382 (proposed Nov. 23, 2010).

⁴ In fact, the Congress has generally sought to provide specific protections to sovereign governments performing governmental activities. See, e.g., the Federal Sovereign Immunities Act, 28 U.S.C. § 1611(b).

⁵ See, e.g., *Vermont Agency of Natural Resources v. U.S. ex rel. Stevens*, 529 U.S. 765, 780 (2000) (applying "our longstanding interpretive presumption that 'person' does not include the sovereign" to exclude States from "person[s]" subject to suit under the False Claims Act); *Will v. Michigan Dept. of State Police*, 491 U.S. 58, 64 (1989) (same, holding a State is not a "person" that can be sued under 42 U.S.C. § 1983); *Breard v. Greene*, 523 U.S. 371, 378 (1998) (per curiam) (foreign sovereign "is not a 'person' as that term is used in § 1983").

⁶ Proposing Release, 76 Fed. Reg. 23732, 23745 (Proposed Margin Rule 23.153(c)). Criteria require generally that the financial entity be subject to capital requirements established by a prudential regulator or state insurance regulator, the entity not have a significant uncleared swap exposure, and the entity use uncleared swaps to hedge or mitigate risks of its business activities. Compare the initial and variation margin threshold provisions described in the Bank Release, available to "low-risk financial end users," who are defined to include financial end users meeting criteria similar to those required in the Margin Rules to qualify for margin thresholds. Bank Release 76 Fed. Reg. 27564, 27571.
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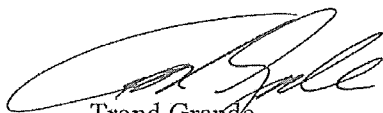
financial entity must meet to qualify for the margin thresholds are manifestly inappropriate for purposes of determining the risk posed by any foreign sovereign entity. For example, the requirement that the entity be "subject to capital requirements established by a prudential regulator or State insurance regulator" would, of course, virtually never be met by a foreign sovereign or its agencies or instrumentalities. In addition, the criteria include limits on the nature and amount of swap activity in which the entity may engage consistent with eligibility for the margin thresholds – limits that are inappropriate in the case of foreign sovereigns and their agencies and instrumentalities, which enter into transactions for a wide variety of governmental purposes, such as in connection with the control of their foreign currencies. The effect of these provisions is to include *all* foreign sovereigns and their agencies and instrumentalities, regardless of their individual credit standings, in a class together with commercial financial entities whose risk profiles do not permit them to benefit from margin thresholds -- reflecting a presumption that is, in our view, inappropriate and not in line with the risks posed by many, if not most, such entities.

In light of the large number and different types of foreign governmental entities who in the normal course of their activities from time to time might transact in the swap markets, we do not believe that a separate classification for sovereign counterparties is necessary or appropriate under the Margin Rules. Rather, we respectfully urge that the Commission remove foreign governments, central banks, and foreign governmental subdivisions, agencies, and instrumentalities from the definition of "financial entity" and allow such entities to agree with their non-bank counterparties the amounts of margin they will be required to post, and the circumstances under which margin will be required.

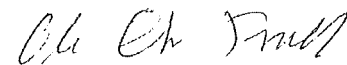
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We hope that you will find these thoughts helpful in your deliberations.

Yours sincerely,



Trond Grande
Deputy Chief Executive Officer
NBIM



Ole Christian Frøseth
Global Head of Treasury &
Fixed Income Trading
NBIM

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