The World Bank
Washington, D.C. 20433
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Secretary of the Commission
Commodity Futures Trading Commission
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International Bank for Reconstruction and Development,
International Finance Corporation, and Other Multilateral
Development Institutions in which the United States is a Member –
Comment on the Proposed Rule Entitled Further Definition of "Swap,"
"Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps;
Security-Based Swap Agreement Recordkeeping (File Number S7-16-11)

COMMENT

Dear Mr. Stawick and Commissioners:

This comment is submitted by the International Bank for Reconstruction and Development ("IBRD" or "Bank") and the International Finance Corporation ("IFC") in respect of implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). IBRD and IFC are international, intergovernmental organizations formed, owned, and controlled by 187 and 182 sovereign members, respectively. The United States is the largest shareholder of each institution.

For the reasons described below, the use of derivatives by IBRD and IFC should continue to be authorized, monitored, and controlled by their sovereign members on a collective basis, rather than through national legislation and regulation. **In particular, we believe that the CFTC should implement the Dodd-Frank Act in a manner that (1) fully respects the privileges and immunities of IBRD, IFC, and other multilateral development institutions, and (2) does not impair the development effectiveness of these institutions. Any other result would be contrary to decades of well-settled US law.**

While this letter focuses on IBRD and IFC, it is being submitted on behalf of all multilateral development institutions in which the United States is a member (collectively, the "MDBs").[1] While some of the specific examples provided below relate

[1] As set forth in 22 U.S.C. §262r(c)(2), (3), and (4), the term "multilateral development institutions" includes IBRD, European Bank for Reconstruction and Development, International Development Association, IFC, Multilateral Investment Guarantee Agency, African Development Bank, African Development Fund, Asian Development Bank, Inter-American Development Bank, Bank for Economic Cooperation and Development in the Middle East and North Africa, and Inter-American Investment

to IBRD and IFC operations and activities, the overall analysis applies to all MDBs – in particular, the consistent treatment of privileges and immunities. All of the MDBs share the same fundamental mission: to promote economic development and reduce poverty in developing and transition countries. Within the World Bank Group, IBRD provides loans to middle income countries, IFC provides loans to and makes equity investments in private sector entities across the developing world, International Development Association provides concessional lending in the form of credits and grants to the poorest countries, and Multilateral Investment Guarantee Agency provides insurance for projects in developing countries. While the other MDBs have a regional focus, all of the MDBs work to promote better economic prospects for the billions of people who still live in poverty in developing and transition countries. The MDBs are a critical part of the post-World War II financial system created by the United States and other sovereigns.

We are taking the opportunity to comment on the proposed rule entitled "Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping," as published in the Federal Register on May 23, 2011 (the "Proposed Rule"). In this letter, we suggest that the CFTC consider using its definitional authority under the Dodd-Frank Act to clarify the definition of "swap" as used in the Commodity Exchange Act, to exclude any agreement, contract, or transaction a counterparty of which is a multilateral development institution as defined in 22 U.S.C.§262r(c)(3), subject to a potential qualification regarding commercial counterparty reporting of transactions with MDBs.

At the same time, the MDBs are open to any other solutions that fully respect our privileges and immunities and do not impair our development effectiveness. In order to be effective, however, any alternate course of action must provide a comprehensive solution, including explicit guidance to our commercial counterparties regarding the status of MDBs – indeed, the need to ensure that we can continue to deal with our United States counterparties under established policies and procedures is one of the primary reasons for filing this comment.

1. IBRD, IFC, and other MDBs operate with the benefit of explicit privileges and immunities: As described in more detail below, the United States Congress has explicitly implemented the privileges and immunities of IBRD, IFC, and other MDBs in US statutory law, and nothing in the Dodd-Frank Act modified or repealed these provisions.

IBRD was established in 1945 and set the model for international development organizations. IBRD, IFC, and other MDBs are managed on a collective governance basis, as the most appropriate framework for international, intergovernmental organizations. In particular, the founding members recognized that being subject to

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Corporation. Not all of these institutions currently use derivatives in their development operations, or do so only on a limited basis. Nevertheless, the principles set forth in this letter should apply to all multilateral development institutions. (One caveat: our understanding is that the Bank for Economic Cooperation and Development in the Middle East and North Africa has never become effective, notwithstanding the authorization for United States membership reflected in the above statutory citations.) While the term MDB is used herein as an abbreviation due to its familiarity, the requested relief encompasses all multilateral development institutions as set forth in 22 U.S.C. §262r(c)(3), so as to cover the Multilateral Investment Guarantee Agency, a member of the World Bank Group.

regulation under a variety of potentially conflicting national laws and regulations would be inefficient at best, and crippling at worst. From the outset, sovereign members codified these principles by granting certain privileges and immunities to IBRD and IFC in their respective Articles of Agreement (and to other MDBs in their equivalent organizational agreements). For the purposes of this discussion, the most salient provisions in the Articles of Agreement of IBRD (referred to as "the Bank" in its Articles) and IFC are as follows:

- "The archives of the Bank shall be inviolable" (IBRD Article VII, Section 5; equivalent provision at IFC Article VI, Section 5);
- "To the extent necessary to carry out the operations provided for in this Agreement and subject to the provisions of this Agreement, all property and assets of the Bank shall be free from restrictions, *regulations*, controls and moratoria *of any nature*" (IBRD Article VII, Section 6 (emphasis added); equivalent provision at IFC Article VI, Section 6);
- "No actions shall . . . be brought [against the Bank] by members or persons acting for or deriving claims from members." (IBRD Article VII, Section 3; equivalent provision at IFC Article VI, Section 3); and
- "Property and assets of the Bank, wherever located and by whomsoever held, shall be immune from search, requisition, confiscation, expropriation or any other form of seizure by executive or legislative action" (IBRD Article VII, Section 4; equivalent provision at IFC Article VI, Section 4).

In addition to embodying these privileges and immunities in the international legal agreements that created IBRD, IFC, and the other MDBs, all member governments agreed to accept and implement these provisions in domestic law. For example, IBRD Article VII, Section 10 provides that "[e]ach member shall take such action as is necessary in its own territories for the purpose of making effective in terms of its own law the principles set forth in this Article and shall inform the Bank of the detailed action which it has taken". IFC Article VI, Section 10 is substantively identical. The United States fulfilled its obligations in respect of IBRD and IFC as follows:

- The Bretton Woods Agreements Act provides that: "the provisions of . . . article VII, sections 2 to 9, both inclusive, of the Articles of Agreement of the Bank, shall have full force and effect in the United States and its Territories and possessions upon acceptance of membership by the United States in, and the establishment of . . . the Bank . . ." (22 U.S.C. §286h)
- The International Finance Corporation Act provides that: "[t]he provisions of . . . article VI, sections 2-9, both inclusive, of the Articles of Agreement of the Corporation shall have full force and effect in the United States and its Territories and possessions upon acceptance of membership by the United States in, and the establishment of . . . the Corporation." (22 U.S.C. §282g)

In addition, the United States has adopted the International Organizations and Immunities Act (22 U.S.C. §288) and the Foreign Sovereign Immunities Act (28 U.S.C. §1602), both of which grant additional protections to IBRD, IFC, and other MDBs.

The organizational documents and charters of the other MDBs contain equivalent privileges and immunities, and the United States has taken appropriate actions to implement its international obligations in domestic law in respect of the other MDBs.[2]

All of these statutory enactments reflect the fact that IBRD, IFC, and the other MDBs are intergovernmental organizations that are formed under international legal agreements and international law. They are not organized under the laws of the United States or any other country. Some of the MDBs – namely, the World Bank Group entities as well as the Inter-American Development Bank – happen to maintain their headquarters in Washington, but this does not change their character as international organizations. The MDBs are not US persons or US residents, and their development activities are directed outside the United States.

The collective governance arrangement has stood the test of time. IBRD, IFC, and the other MDBs have been able to operate effectively and efficiently on a global basis with the benefit of both the privileges and immunities described above and with the understanding of the United States and other governments that national regulatory regimes were not intended to apply to the activities of international organizations. In the United States, the securities of IBRD and IFC are "exempted securities" under the Securities Act of 1933 and the Securities Act of 1934,[3] as are the securities of other MDB issuers. In 1955, the SEC confirmed in writing (immediately prior to the passage of the International Finance Corporation Act) that IFC (like IBRD before it) was not the type of organization that Congress intended to subject to regulation under the Investment Company Act of 1940. In 2001, the SEC exempted the IBRD and International Development Association from regulation under the Investment Advisers Act of 1940, for similar reasons.

The EU has a similar, consistent record of regulatory forbearance, expressly exempting MDBs from the recent Prospectus Directive and Transparency Directive. Perhaps more salient for the current discussion, the proposed European Market Infrastructure Regulation – which is intended to serve as the European counterpart to Title VII of the Dodd-Frank Act – expressly excludes "multilateral development banks" such as IBRD and IFC from its coverage.

The principle that MDBs are not subject to national regulation extends across the board. Various MDBs provide banking and insurance products, and hold funds in trust –

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[2] See, e.g., 22 U.S.C. §283g (Inter-American Development Bank Act), 22 U.S.C. §283hh (Inter-American Investment Corporation Act), 22 U.S.C. §284g (International Development Association Act), 22 U.S.C. §285g (Asian Development Bank Act), 22 U.S.C. §290g-7 (African Development Fund), 22 U.S.C. §290*i*-8 (African Development Bank Act), 22 U.S.C. §290*k* -10 (Multilateral Investment Guarantee Agency Act), 22 U.S.C. §290*l*-6 (European Bank for Reconstruction and Development Act), and 22 U.S.C. §290*o* (Bank for Economic Cooperation and Development in the Middle East and North Africa Act).

[3] See 22 U.S.C. §282k and 22 U.S.C. §286k-1.

but these activities are not subject to national or local banking, insurance, or trust laws. The human resource rules applicable to MDB management and staff are determined internally and disputes are resolved within each organization. MDBs are exempt from taxation of all kinds.

2. *The CFTC should take appropriate action to ensure that implementation of Title VII of the Dodd-Frank Act does not conflict with the status of the MDBs:* If the Dodd-Frank Act were interpreted to impose national regulation on the activities of IBRD, IFC, and other MDBs, it would represent an unprecedented intrusion on the internal operations of these international, intergovernmental organizations, and a clear deviation from the pattern of the last 65 years. **More importantly, application of Title VII of the Dodd-Frank Act to IBRD, IFC, and the other MDBs would be inconsistent with the international obligations of the United States and would directly conflict with existing United States statutory law, as detailed above.**

To take the most obvious example, attempts to impose a regulatory inspection regime on MDBs would be flatly inconsistent with Article VII, Sections 4 and 5 of IBRD's Articles of Agreement and equivalent provisions in the constitutional documents of other MDBs. To take another prominent example, IBRD, IFC, and the other MDBs are facing increased global demand for financing in the wake of the financial crisis, and their core development functions could be impaired by the imposition of national regulatory capital requirements. Potential national regulation of capital usability strikes at the heart of the governance issue raised above: in effect, a regulator in one country could override the judgment of as many as 186 other sovereigns regarding the appropriate use of the taxpayer-funded capital that such sovereigns have contributed to the MDBs over the years – or that they may contribute in the future in connection with pending general or selective capital increases at several MDBs. Such a requirement would also conflict with Article VII, Section 6 of IBRD's Articles of Agreement and equivalent provisions in the charters of other MDBs. Numerous other provisions of Title VII would conflict with the privileges and immunities of MDBs, as implemented in US law, but we believe that the above examples make our concerns clear.

There is no evidence that Congress intended such a result. In the absence of explicit Congressional instructions to the contrary, the CFTC should use whatever tools it has at its disposal to interpret and implement the Dodd-Frank Act in a manner that is consistent with decades of well-settled United States legislation and the international agreements and obligations of the United States in respect of IBRD, IFC, and the other MDBs.

We do not believe that a regulatory agency, in implementing a new statute, can abrogate the international obligations of the United States or engage in a de facto repeal of controlling statutory law. Even if such authority arguably existing, there is nothing in the legislative or regulatory record that would provide a reasonable basis for such a result in this case. For example, the use of derivatives by MDBs does not present undue risk to the financial markets. To the contrary, IBRD, IFC, and other MDBs use derivatives for hedging purposes, within a robust risk management framework.[4] Moreover, while the

[4] See Annex 1 for more information on the use of derivatives by MDBs.

MDBs play an important role in catalyzing development financing, the overall volume of their transactional activities is relatively small compared to other market participants who are already exempt from most or all requirements under the Dodd-Frank Act. Accordingly, exclusion of MDB transactional activity from regulation would not frustrate or impair any of the purposes of the Dodd-Frank Act.

Moreover, excluding MDBs from regulation under the Dodd-Frank Act would not mean that these institutions would be free from official oversight. To the contrary, IBRD and IFC have resident Boards, with all members appointed or elected by their sovereign shareholders, including the United States. The resident Boards (and the Audit Committee thereof) have in-depth familiarity with, and oversight authority over, IBRD's and IFC's financial operations. Among other responsibilities, the Boards authorize all categories of derivatives use by IBRD and IFC, and receive regular reports on treasury and risk management operations. While the Boards of MDBs are not acting as regulators, they are all concerned with the financial health and sustainability of their respective institutions, and take risk management issues seriously.

We understand that the Commission is dealing with requests from many other parties for relief from various provisions of the Dodd-Frank Act. To the best of our knowledge, the case set forth above on behalf of the MDBs is unique, premised as it is on specific international obligations of the United States and explicit statutory provisions. We respectfully submit that the Commission has ample grounds for distinguishing the status of the MDBs from that of other parties commenting on the Proposed Rule or other Dodd-Frank Act implementation measures.

3. *The Further Definition of the Term "Swap" Provides One Option for Resolving Any Potential Conflict:* Our view is that one potentially efficient and effective mechanism for dealing with this issue is for the CFTC to define the term "swap" to exclude transactions with MDBs of which the United States is a member. Section 712(d)(1) of the Dodd-Frank Act expressly directs the CFTC and other relevant agencies to further define the terms "swap" and "security-based swap", implicitly recognizing that the current definitions are not complete and comprehensive:

> Notwithstanding any other provision of this title and subsections (b) and (c), the Commodity Futures Trading Commission and the Securities and Exchange Commission, in consultation with the Board of Governors, shall further define the terms "swap" [and] "security-based swap" . . . .

Section 712(d)(2)(A) of the Dodd-Frank Act provides further authorization regarding definitions to the CFTC and the other relevant agencies:

> Notwithstanding any other provision of this title, the Commodity Futures Trading Commission and the Securities and Exchange Commission, in consultation with the Board of Governors, shall jointly adopt such other rules regarding such definitions as the Commodity Futures Trading Commission and the Securities and Exchange Commission determine are

> necessary and appropriate, in the public interest, and for the protection of investors.

As the introductory language to each of the provisions quoted above makes clear, the authority of the CFTC and the SEC to define such terms is not subject to any other provisions or limitations in Title VII. Moreover, the definitions of "swap" and "security-based swap" – which Congress expressly directed the SEC and the CFTC to further define – already include exclusions for transactions by certain United States official sector entities. To the extent that the CFTC and the SEC determine that additional official sector entities in which the United States is a shareholder were not specifically intended to be covered by Title VII, the definitions of "swap" and "security-related swap" provide an appropriate vehicle for codifying this conclusion. To the extent that Section 712(d)(2)(A) is relevant, we believe that the facts set forth elsewhere in this letter make the case that the public interest would best be served by facilitating the developmental and poverty reduction missions of the MDBs under the current collective governance model.

Finally, as evidenced by the SEC interpretations of the Investment Company Act of 1940 and the Investment Advisers Act of 1940 referenced above, there is no need for a statute to include an explicit exemption for MDBs for the relevant regulator to reach a conclusion that such international, intergovernmental organizations should be excluded from regulation.

Notwithstanding the foregoing, IBRD, IFC, and the other MDBs have no objection to reporting by our commercial counterparties of transactions with our institutions. In this regard, the exclusion of MDB transactions from the definition of the term "swap" could be qualified by a requirement that our counterparties treat such transactions as swaps solely for their own reporting purposes. Reporting by our counterparties should provide the CFTC with an effective means for monitoring both individual counterparty exposure and the market as a whole.

4. IBRD, IFC, and the Other MDBs are Open to Other Solutions: While we are commenting on the Proposed Rule, IBRD, IFC, and the other MDBs would welcome any other regulatory action by the CFTC that would implement Title VII of the Dodd-Frank Act in a manner that (1) fully respects the privileges and immunities of IBRD, IFC, and the other MDBs, and (2) does not impair the development effectiveness of these institutions.

The first prong of this test is relatively clear – as discussed in more detail above, direct regulation of the operations of an international, intergovernmental organization by a national regulator would be flatly inconsistent with existing law. However, we note that any such alternative remedial action would need to be comprehensive in nature. For example, categorical exclusion from the definitions of "swap dealer" and "major swap participant" would still leave MDBs exposed to regulation and inspection requirements that are inconsistent with MDB charters and US law. Moreover, exclusion from regulation as a swap dealer or major swap participant would not deal with certain indirect regulation issues. Exclusion of MDB transactions from the definition of "swap" – subject

to a qualification for counterparty reporting of transactions with MDBs – would provide a comprehensive solution to all of these issues.

The second prong of the above test deserves more elaboration. IBRD, IFC, and other MDBs use over-the-counter ("OTC") derivatives to hedge currency, interest rate, and other market risks in lending, borrowing, equity management, and investment operations, and to provide equivalent risk management tools to member countries and other clients in developing countries and other official sector institutions. For example, IBRD, IFC, and other MDBs are able to borrow in currencies and interest bases that offer the lowest possible cost, and then on-lend to countries and other clients in the currencies and interest bases that match these countries' and clients' needs through the use of derivatives that hedge interest rate and currency risk. **The use of derivatives for risk management purposes is integral to the development operations of IBRD, IFC, and other MDBs – indeed, it is difficult to imagine how any of these institutions could operate effectively in a multi-currency, floating rate environment *without* the use of derivatives.**[5]

MDBs support the further development of stable and transparent derivatives markets and are not opposed on principle to new initiatives such as increased clearing of swaps. At the same time, however, MDBs have a mandate to maximize the development value of the capital entrusted to them by their sovereign shareholders. MDBs should retain the ability to evaluate the new market infrastructure and trading practices as they develop to determine which, if any, are appropriate for their operations. Accordingly, Title VII of the Dodd-Frank Act should be implemented in a way that does not – directly or indirectly – impair the development effectiveness of IBRD, IFC, and the other MDBs. In particular, rules should be tailored so that they do not indirectly impose potentially burdensome mandatory clearing and collateralization requirements on MDBs, which could increase risks, costs, and divert scarce working capital from critical development needs. In order to deal with these issues, any alternate solution must provide explicit guidance to US commercial counterparties regarding the status of MDBs.[6] As noted above, however, we have no objections to requirements that our counterparties report on transactions with MDBs.

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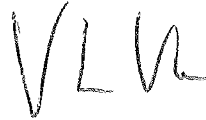
[5] Beyond lowering borrowing costs and providing risk management solutions to clients, the use of derivatives by MDBs also allows them to further the development of local bond markets and long-term local currency loans, both of which are priorities of the G20.

[6] Given the explicit exemption for MDBs in the proposed European Market Infrastructure Regulation, MDBs could potentially focus on European counterparties for future hedging transactions if there is no clear exception in the US market. We doubt that Congress intended to create a situation in which MDBs would have concrete incentives to move their trading activities away from US financial institutions.

5. Summary: IBRD, IFC, and other MDBs use OTC derivatives in a responsible manner, subject to appropriate risk management measures and under the oversight of sovereign shareholders. The collective governance mechanism for international organizations has worked well for over 65 years, and there is no evidence that the Dodd-Frank Act was intended to alter this arrangement in any way. The derivatives activities of the MDBs account for a fraction of a multi-trillion dollar market, and do not represent any real risk to the international financial system. The Dodd-Frank Act should be implemented in a manner that fully respects the privileges and immunities of IBRD, IFC, and other MDBs and excludes them from regulation. We have attached for your consideration the proposed text of a definition of the term "swap" under section 1a(47) of the Commodity Exchange Act that would exclude transactions with MDBs.

IBRD and IFC have already met with some of the Commissioners and their staff regarding the Dodd-Frank Act, and we would welcome the opportunity to engage in further consultations about any other potential implementations options that the Commissioners or the staff believe would be appropriate in the circumstances. Furthermore, we may take the opportunity to supplement this comment with additional analysis and information.

Sincerely,



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Mr. Thierry De Longuemar, Treasurer, Asian Development Bank
Ms. Isabelle Laurent, Deputy Treasurer and Head of Funding, European Bank for Reconstruction and Development
Mr. John Borthwick, Deputy Treasurer, International Finance Corporation
Ms. Doris Herrera-Pol, Director, Capital Markets, The World Bank

Attachment 1: Use of Derivatives by Multilateral Development Banks (MDBs)[7]

MDBs use over-the-counter (OTC) derivatives to manage their exposure to fluctuations in interest and currency rates, to reduce funding costs of their borrowing activities, to control risk and improve return in their reserves portfolios, and to provide risk management solutions for clients. We do not use derivatives for speculation.

MDBs use derivatives in connection with their liabilities to diversify funding sources and offer new debt products to investors. Generally, MDBs swap new funding into the main currency(ies) of denomination and interest rate bases of their emerging market loan assets to minimize currency and interest rate risks in their balance sheets. Conversion to other currencies or into fixed-rate funding is carried out subsequently, also through swaps, in accordance with clients' choices of loan terms. MDBs also use interest rate swaps and currency swaps for asset-liability management purposes to match the pool of liabilities as closely as possible to the interest rate and currency characteristics of liquid assets and loans.

In addition to activity for their own accounts, MDBs facilitate access to hedging tools for their clients and other international development institutions to help meet risk management needs.[8] Provision of instruments such as currency swaps (including into clients' local currencies) and interest rate swaps, caps and collars assists clients in managing interest rate and currency risks, while less common tools such as drought risk contracts have helped with more fundamental environmental and development issues. MDBs fully offset the exposure they create providing these services by hedging them in the derivatives market.

Customized derivatives are an important part of MDBs' development banking operations. These tools allow MDBs to transform the cashflows of their loans to meet changing clients risk management needs. Clients can eliminate foreign exchange risk by hedging cashflows into their local currency, and eliminate debt service fluctuations by fixing the interest rates on their loans.

MDBs have the capacity to effectively manage OTC derivatives operations, including transaction valuation tools and collateral management operations. All MDBs control the credit exposures on swaps through specific credit-rating requirements for

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[7] The information contained herein pertains to multilateral development banks of which the United States is a shareholder and that are active users of the international capital markets. Besides the IBRD and the IFC, these are: African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, and Inter-American Development Bank.

[8] For example, at present IBRD intermediates currency and interest rate hedging tools for two other international development institutions: the International Finance Facility for Immunisation (IFFIm) and the International Development Association (IDA), another member of the World Bank Group. In both cases, IBRD's derivatives intermediation helps to ensure that the value of multi-year pledges by donor governments in various currencies are insulated from foreign exchange movements, so that IFFIm and IDA can plan multiyear vaccine purchase and development projects, respectively, all for the benefit of the poorest countries.

counterparties and other credit assessment tools used by independent credit risk units. MDBs also manage risk through netting, collateralization and other arrangements in the legal agreements governing derivatives transactions.

MDBs have robust capital structures and backing from sovereign shareholders. MDBs are among the safest counterparties in the markets, as recognized by the low risk weightings assigned to transactions with MDBs by banking regulators under the Basel II framework and the high ratings assigned by credit rating agencies. While MDBs are an important part of the international financial system, the aggregate volume of derivatives transactions involving MDBs are not so large as to create systemic risk in the market.

Attachment 2: Potential Exclusion from the Definition of Swap

Commodity Exchange Act § 1a(47)

(47) Swap.—

(A) In general.—Except as provided in subparagraph (B), the term "swap" means any agreement, contract, or transaction—

(i) . . .

(B) Exclusions.—The term "swap" does not include—

(i) . . .

(xi) any agreement, contract, or transaction a counterparty of which is a multilateral development institution, as defined in section 1701(c)(3) of the International Financial Institutions Act (22 U.S.C. 262r(c)(3)).