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September 14, 2012

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
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Washington, DC 20581

Office of the Secretariat
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Received CFTC
COMMENT

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 "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants"[1]

Dear Mr. Stawick and Commissioners:

This comment is submitted by the International Bank for Reconstruction ("IBRD") and the International Finance Corporation ("IFC"), on behalf of IBRD, IFC, and other multilateral development banks in which the US is a member (the "MDBs") in respect of implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). For the reasons set forth below, we request that the Commission ensures that the above-referenced proposal is implemented in a manner that does not impair the ability of MDBs to continue to engage in non-cleared swaps with swap dealers and major swap participants on a mutually agreed, bilaterally negotiated basis, rather than being subject to regulatory margin requirements.

1. Prior Comments by IBRD and IFC and Related Commission Decisions

IBRD and IFC filed a 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" on July 22, 2011.[2] In that comment, IBRD and IFC urged the Commission to implement the Dodd-Frank Act in a manner that (1) fully respects the privileges and immunities of IBRD, IFC, and other MDBs, and (2) does not impair the development effectiveness of these institutions, noting that any other result would be contrary to decades of well-settled law. Our comment described the privileges and immunities accorded to IBRD, IFC, and other MDBs, and explained that application of Title VII of the Dodd-Frank Act to these institutions would be inconsistent with the international legal obligations of the United States and would conflict with U.S. statutory law. Our comment further noted that there was no

[1] 76 Fed. Reg. 23,732 (April 28, 2011).

[2] A copy of this comment is attached as Attachment 1.

evidence that Congress intended such a result. While the comment was filed in response to the proposed "product definition" rules, IBRD and IFC noted that the MDB community would welcome any regulatory action (or actions) that met the two-pronged test set forth above.

The Commission (in conjunction with the Securities and Exchange Commission) subsequently adopted a rule entitled "Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant' and 'Eligible Contract Participant'". In discussing the status of certain foreign entities, the Commission cited the above-referenced comment letter filed by IBRD and IFC. In this rule-making process, the Commission expressly determined that:

> Canons of statutory construction "assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws." There is nothing in the text or history of the swap-related provisions of Title VII to establish that Congress intended to deviate from the traditions of the international system by including foreign governments, foreign central banks and international financial institutions within the definitions of the term "swap dealer" or "major swap participant," thereby requiring that they affirmatively register as swap dealers or major swap participants with the CFTC and be regulated as such. The CFTC 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.[3]

The Commission subsequently adopted a rule entitled "End-User Exception to the Clearing Requirement for Swaps". In discussing the status of certain foreign entities, the Commission again cited the above-referenced comment letter filed by IBRD and IFC. In this rule-making process, the Commission followed the reasoning set forth in the above-referenced decision and determined that:

> Canons of statutory construction "assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws." In addition, international financial institutions operate with the benefit of certain privileges and immunities under U.S. law indicating that such entities may be viewed similarly under certain circumstances. There is nothing in the text or history of the swap-related provisions of Title VII of the Dodd-Frank Act to establish that Congress intended to deviate from the traditions of the international system by subjecting foreign governments, foreign central banks, or international financial institutions to the clearing requirement set forth in Section 2(h)(1) of the CEA.
>
> Given these considerations of comity and in keeping with the traditions of the international system, the Commission believes that foreign governments, foreign central banks, and international financial institutions should not be subject to Section 2(h)(1) of the CEA.[4]

[3] 77 Fed. Reg. 30,596 (Mary 23, 2012), at page 30,693 (footnotes omitted) (the "Entity Definitions Release"). Footnote 1180 on page 30692 defined the term "international financial institutions" to include, inter alia, IBRD, IFC, and other MDBs in which the United States is a member.

[4] 77 Fed. Reg. 42,560 (July 19, 2012), at page 42,562 (footnotes omitted) (the "Clearing Release").

We welcome these decisions that IBRD, IFC, and the other MDBs will not be required to register as swap dealers or major swap participants, or be subject to swap clearing requirements. In particular, we welcome the explicit Commission recognition of the importance of the privileges and immunities accorded to international financial institutions. These two decisions minimize the potential for direct regulation, which would be flatly inconsistent with the privileges and immunities of our organizations. However, these decisions do not address certain other key issues. Indeed, the Clearing Release went on to state the following:

> The Commission notes, however, that if a foreign government, foreign central bank, or international financial institution enters into a non-cleared swap with a counterparty who is subject to the CEA and Commission regulations with regard to that transaction, then the counterparty still must comply with the CEA and Commission regulations as they pertain to non-cleared swaps. For example, the party must comply with the recordkeeping and reporting requirements under Parts 23 and 45 of the Commission's regulations.[5]

This statement suggests that the pending rule regarding margin requirements for uncleared swaps could be applied to transactions between MDBs and swap dealers and major swap participants. Accordingly, we are filing this comment to ensure that the above-referenced rule is implemented in a manner consistent with the principles articulated in our original comment letter, as well as the Commission's own reasoning in the Entity Definitions Release and the Clearing Release.

As discussed in more detail below, the swap operations of IBRD, IFC, and other MDBs do not present a risk to US financial institutions or to the financial system as a whole. Therefore, imposing margin requirements on transactions with the MDBs would serve no useful purpose – instead, it would divert scarce public resources from development needs and degrade the financial capacity and credit standing of the MDBs. The United States is the largest shareholder in IBRD and IFC, as well as the largest contributor to IBRD's ongoing capital increases, and has a strong interest in ensuring that public funds appropriated by Congress have the maximum development impact.

2. *Margin Requirements on MDB Transactions Would Conflict with the Privileges and Immunities of MDBs*

Regulation of non-cleared swap transactions between MDBs and swap dealers or major swap participants would amount to regulation of MDBs, and would be inconsistent with the privileges and immunities of IBRD, IFC, and the other MDBs. In response to a question raised by Chairman Gensler at a July 6, 2011 meeting, we commissioned the firm of Sullivan & Cromwell to analyze the potential application of the Dodd-Frank Act to our swaps activities. Edwin Williamson, currently Senior Counsel to Sullivan & Cromwell and former Legal Adviser of the U.S. Department of State, was the primary author of the opinion, which we transmitted to Chairman Gensler on October 5, 2011.[6] The Sullivan & Cromwell opinion confirmed that regulation of IBRD and IFC under Title VII of the Dodd-Frank Act would constitute a breach by the United States of its international obligations under the Articles of Agreement of each institution, as implemented in U.S. law under the Bretton Woods Agreements Act and the

[5] 77 Fed. Reg. 42,560, at page 42,562. The July 22, 2011 IBRD and IFC comment letter noted at page 7 that IBRD, IFC, and the other MDBs have no objection to reporting by our commercial counterparties of swap transactions with our institutions.

[6] A copy of our transmittal letter and the Sullivan & Cromwell opinion is set forth as Attachment 2.

International Finance Corporation Act. The opinion further concluded that the Dodd-Frank Act does not authorize any such curtailment of the privileges and immunities of IBRD and IFC.

While we urge that the entire Sullivan & Cromwell opinion – as well as our own prior discussion of privileges and immunities – be reviewed in detail, certain sections of the opinion merit special emphasis in the context of the proposed rule at issue. The opinion noted at page 11 that regulation could be imposed either through "Direct Regulation" of IBRD and IFC, or via what it termed "Direct Regulation Equivalent" measures:

> Even if the Organizations [IBRD and IFC] are not required to register as MSPs, if their swap transactions are covered, then transactions with entities that are MSPs or "swap dealers" would subject the Organizations to several of the Direct Regulation measures. For example, the Organizations would be required to post collateral as security for their swap obligations . . . This is in many ways the substantive equivalent of the Organizations being subjected to Direct Regulation, as the Regulations would have the effect of requiring the Organizations to modify their current practices.

The Sullivan & Cromwell opinion then analyzed such collateral requirements in detail on page 12 and concluded as follows:

> The requirement that the Organizations post collateral would violate the Organizations' immunities from attachment and seizure, whether the requirement is imposed as a Direct Regulation or a Direct Regulation Equivalent measure. The Organizations' attachment immunity protects the Organizations' assets from an attachment before the entry of a final judgment. Posting collateral in order to enter into a transaction, particularly when there is no indication that the collateral will ever be called, is the economic equivalent of an attachment prior to a judgment having been entered. The Organizations' immunity from seizure protects the Organizations from any government's attempt to, among other things, requisition the Organizations' assets, such as by requiring that the Organizations use their assets in a prescribed manner. Likewise, requiring that the Organizations use their assets for a purpose other than for the furtherance of their development purposes is the economic equivalent of a requisition, even if it is for a limited purpose.

We believe that this reasoning is compelling, and makes the case that margin requirements on uncleared swaps should not be applied to transactions involving MDBs.

One final point deserves comment. The Entity Definitions Release included a statement that "foreign entities are not necessarily immune from U.S. jurisdiction for commercial activities undertaken with U.S. counterparties or in U.S. markets," and a related footnote that included citations to certain litigation involving MDBs.[7] We filed a letter suggesting a clarification to this discussion, because we believed it to be potentially confusing.[8] In particular, we noted that the immunity of the MDBs from member state regulation and other actions, as set forth in their respective Articles of Agreement and related U.S. implementing legislation, is not affected by

[7] 77 Fed. Reg. 30,692 and footnote 1182.

[8] A copy of this letter is attached as Attachment 3.

whether MDBs engage in commercial behavior. In other words, the general "commercial exception" to sovereign immunity set forth in the Foreign Sovereign Immunities Act, as cited in footnote 1182 of the Entity Definitions Release, does not apply to or limit the immunities conferred on MDBs – the FSIA applies to sovereigns, and MDB privileges and immunities are specified in independent international agreements and different U.S. statutes. Moreover, the court cases cited in the footnote referred to MDB immunity from suits by private parties rather than the entirely distinct immunities from regulation and other actions by members. These points apply equally to the margin rule currently under consideration – the specific immunities of the MDBs from regulation, requisition, seizure, and so on must be considered on their own merits. The regulatory immunity accorded to IBRD and IFC, for example, expressly extends to "restrictions, regulations, controls, and moratoria *of any nature*",[9] and should not be confused with more limited forms of immunity applicable to other types of entities and activities.

3. *Margin Requirements on MDB Transactions Would Be Inconsistent with the Commission's Statutory Mandate and Would Serve No Policy Purpose*

While the privileges and immunities argument set forth above should be dispositive, we also believe that margin requirements would have detrimental effects on our development operations, without corresponding benefits. Some of the specific comments and financial analysis in this section focus on IBRD and IFC, but they apply more broadly to the MDBs as a whole.

The Commission itself described its statutory mandate and articulated the policy goals of the proposed rules under consideration as follows:

> Section 4s(e)(3)(a) [of the Commodities Exchange Act, as amended by the Dodd-Frank Act] states the need to offset the greater risk that swaps that are not cleared pose to SDs, MSPs, and the financial system, and directs the Commission . . . to adopt capital and margin requirements that (1) Help ensure the safety and soundness of the [swap dealer or major swap participant] registrant; and (2) are *appropriate for the risk associated with the uncleared swaps they hold.*[10]

IBRD and IFC are highly credit-worthy entities. Our institutions carry the highest ratings issued by the major credit rating agencies. Moreover, the trading history of bonds issued by IBRD and IFC demonstrates broad market consensus that our institutions (and other MDBs) are among the safest credits in the capital markets. Furthermore, regulators have taken the same view in setting capital requirements for transactions between regulated entities and MDBs. For example, the federal banking agencies' rules implementing the Basel II internal ratings-based approach exempt any MDB from the minimum probability of default floor of 0.03% for purposes of calculating risk-weighted assets for general credit risk – i.e., they allow regulated entities to assess the MDB default probability as *zero*.[11] In addition, the recent U.S. Basel III proposals, introducing a new standard to replace U.S. Basel I, known as the Basel III "standardized approach," reduces the risk weight for exposures to MDBs from 20% to *zero* (0%), effective January 2015.[12] Finally, under the Market Risk Capital Rule recently adopted by the federal

[9] IBRD Article VII, Section 6 (emphasis added); equivalent provision at IFC Article VI, Section 4.

[10] 76 Fed. Reg. 23733 (emphasis added).

[11] See e.g., 12 C.F.R. Part 225 Appendix G, Section 31(d) (2).

[12] As a rationale for assigning a zero percent risk weight to exposures to MDBs, the U.S. federal banking agencies stated that this is appropriate "in light of the generally high-credit quality of MDBs, their strong shareholder support, and a shareholder structure

banking agencies, US banks may assign a *zero* specific risk-weighing factor to a debt position that is (or has) an (underlying) exposure to an MDB.[13]

Finally, it is worth reiterating that IBRD, IFC, and the other MDBs use swaps solely for risk management purposes. We use these transactions in a straightforward manner, to manage market risk, stabilize income, and help our clients manage market risks. We do not use derivatives for speculation.[14]

As the Commission itself noted in proposing the margin rules, its statutory mandate is to adopt capital and margin requirements that are "appropriate for the risk associated with the uncleared swaps" held by swap dealers and major swap participants. There is a clear consensus among credit rating agencies, capital markets participants, and regulatory capital standard setters that exposures to MDBs pose no serious risks. Indeed, margin requirements on swaps with MDBs would be inconsistent with a broad body of national and international regulatory decisions regarding capital requirements for exposures to MDBs. Accordingly, we believe that imposing margin requirements on swap transactions with MDBs is inconsistent with the Commission's statutory mandate and serves no policy purpose.[15]

4. Margin Requirements on MDB Transactions Would Impair the Development Effectiveness of MDBs

IBRD has undertaken an analysis of potential margin posting requirements under various scenarios, and concluded that it could face a potential posting requirement over the medium term of $20-30 billion under plausible scenarios. Assuming that IBRD would borrow in the financial markets to fund such a collateral requirement, we estimate that our funding cost for collateral would exceed the returns on the very narrow class of assets eligible for posting by approximately 20-30 bps. This suggests a possible cost of carry in the range of $40-90 million per year. This estimate is for IBRD alone; the costs for IFC and other MDBs would be on top of this amount. In addition to cost issues, this liquidity impact should be considered in the context that none of the MDBs has access to a liquidity facility of last resort from the Federal Reserve or other central banks. While some (but not all) MDBs have callable capital, even those MDBs with callable capital backing cannot call it for purposes other than servicing our bond debt and guarantee obligations. This potential loss of tens of millions of dollars per year is a pure deadweight loss that adversely impacts our financial position. Losses of this level will constrain our ability to increase IBRD's financial capacity and to make transfers of IBRD's net income to other development entities, such as the International Development Association (IDA), the concessional

comprised of a significant proportion of sovereign entities with strong creditworthiness." *Federal Reserve, FDIC and OCC*, Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements, 77 Fed. Reg. 52,888 at 52,896 (Aug. 30, 2012).

[13] Similarly, in the preamble to the Market Risk Capital Rule, the federal banking agencies stated that the zero percent specific risk-weighting factor "is based on these MDBs' generally high-credit quality, strong shareholder support, and a shareholder structure comprised of a significant proportion of sovereign entities with strong creditworthiness." *Federal Reserve, FDIC and OCC*, Risk-Based Capital Guidelines: Market Risk, 77 Fed. Reg. 53,060 at 53,077 (Aug. 30, 2012).

[14] For a more detailed description of how MDBs use swaps, see Attachment 1: Use of Derivatives by Multilateral Development Banks (MDBs) to the July 22, 2011 comment letter.

[15] As noted in the Sullivan & Cromwell opinion at page 14 – and confirmed by us herein – the ISDA Master Agreements under which IBRD and IFC conduct swap transactions with commercial counterparties in the US and other jurisdictions provide that IBRD and IFC will not post margin as long as they are rated "AAA" by the major ratings agencies, but will post margin if they are downgraded. Thus, the only effect of imposing regulatory margin requirements on uncleared swaps with IBRD and IFC would be to require our institutions to post margin at a time when they present minimal or no risk to our counterparties.

lending arm of the World Bank Group. This would be in contradiction of the stated policy objectives of the United States as the largest shareholder of IDA.

Some other potential implications are more difficult to quantify, but may be more serious over the long term. IBRD, IFC, and the other MDBs responded to the financial crisis by substantially increasing lending and investment operations, and the elevated level of such operations is expected to continue over the medium term. If we are forced to incur substantial additional borrowings to cover collateral posting requirements above and beyond the level necessary to fund lending and investments, the consequences are uncertain. At a minimum, IBRD, IFC, and the other MDBs will need to hold some capital against the assets that are posted with counterparties, which will either reduce our lending ability or increase our leverage above normal levels. While we will do everything we can to ensure that this situation is managed in a responsible manner, it is possible that the financial markets will take a negative view of a historically unprecedented degree of leverage in our operations.

There are other potential implications as well. IBRD currently provides swap intermediation services for IDA and other development clients. For example, IBRD's swap intermediation services hedge the pledges IDA receives in various currencies into its Special Drawing Right base, so that IDA is protected against foreign exchange risk and can make firm commitments. IDA is not required to post collateral on these transactions, since IBRD is not required to post collateral on its mirror swaps with the market. If IBRD is subject to margin requirements on its transactions with swap dealers and major swap participants, however, this arrangement would be difficult to continue and likely will require IDA and IBRD's other clients to begin posting collateral as well to avoid putting further pressure on IBRD's finances and credit standing. This may significantly increase the cost of doing business for these agencies which provide extremely low cost funding for development, including access to medicine, to the poorest of the poor.

In summary, applying margin requirements to uncleared swaps with MDBs will increase costs, limit lending and investment operations, divert the use of scarce capital, and potentially affect concessional aid to the poorest of the poor – all for no real policy benefit. Since the United States is the largest shareholder in IBRD, IFC, and other MDBs, and the largest contributor to IBRD's current capital increases, we believe that such an outcome would frustrate U.S. policy interests.

5. *Margin Requirements on MDB Transactions Would Create International Comity Concerns*

Finally, we note that the more general international comity considerations articulated by the Commission – most explicitly in the Clearing Release – independently argue for the result that we are requesting:

> The Commission expects that if any of the Federal Government, Federal Reserve Banks, or *international financial institutions of which the United States is a member* were to engage in swap transactions in foreign jurisdictions, the actions of those entities with respect to those transactions would not be subject to foreign regulation. However, if foreign government, central banks, or *international financial institutions* were subjected to regulation by the Commission in connection with their swap transactions, foreign regulators could treat the Federal

> Government, Federal Reserve Banks, or *international financial institutions of which the United States is a member* in a similar manner.[16]

To be clear, our primary argument for relief from clearing requirements on MDB transactions is that such relief is required as a matter of international and domestic U.S. law, as a consequence of our privileges and immunities. This is entirely independent of comity concerns.[17] However, the Commission's reasoning regarding the international comity interests of the United States applies just as strongly to margin requirements on uncleared swaps as to clearing requirements for other swaps, and provides yet another independent basis for reaching this result. It is particularly notable that Commission's stated expectation is that "the actions of those [U.S.] entities with respect to those transactions would not be subject to regulation" – i.e., the concern relates to regulation of the relevant *transactions*. An identical concern would arise if a foreign regulator required financial institutions under its jurisdiction to require margin on uncleared swaps from the aforementioned U.S. entities.

Taking all of the above factors into account, we believe that the legal and policy considerations that led the Commission to exclude IBRD, IFC, and the other MDBs from swap dealer and major swap participant registration requirements and swap clearing obligations should equally apply in the case of margin requirements, with a similarly comprehensive solution. In particular, just as in those other cases, there is nothing in the text or history of the swap-related provisions of Title VII of the Dodd-Frank Act to establish that Congress intended to deviate from the above-referenced international standards, including the privileges and immunities granted to the MDBs, in the case of margin rules.

Accordingly, the final rule or release in the above-referenced matter should include a clear statement that the margin requirements on uncleared swaps will not apply to transactions with the MDBs, and that swap dealers and major swap participants will continue to be authorized to negotiate agreements with and enter into transactions with MDBs on a mutually agreed basis.[18]

6. Further Regulatory Clarifications: "financial entity" and "U.S. person"

We would also like to take the opportunity of this comment to address certain other matters involving implementation of Title VII of the Dodd-Frank Act.

Financial Entity - General

In the Clearing Release, immediately following the statement quoted on page 2 above, the Commission stated that "[a]ccordingly, it is not necessary to determine whether these entities are 'financial entities' under Section 2(h)(7) of the CEA." We agree that the clearing issue could be resolved without determining whether MDBs are "financial entities". We also believe that the issue regarding margin for uncleared swaps could be resolved by a similar categorical statement without reaching this definitional issue. However, the answer to that question is still important

[16] 77 Fed. Reg. 42561-2 (emphasis added).

[17] Indeed, comity is not generally an issue in the case of MDBs, because all MDB members are similarly obligated as a matter of international law.

[18] We do not object to *all* potential requirements imposed on swap dealers and major swap participants in respect of transactions with MDBs – only those that would impair our development effectiveness. As noted above, MDBs have no objection to swap dealers and major swap participants being required to keep records and report on uncleared swaps undertaken with MDBs.

for other purposes: namely with regard to the Commission's reporting mandate[19] and the requirement to provide a representation with regard to being a "financial entity" under ISDA's 2012 Dodd-Frank Protocol.[20]

Our view is that MDBs should not be considered to be "financial entities". MDBs are official sector entities whose operations focus on development lending and investment. We note that the explanation of the "financial entity" definition in the context of the proposed rule under discussion stated that: "[t]he Commission believes that financial entities, which generally are not using swaps to hedge or mitigate commercial risk, potentially pose greater risk to CSEs than non-financial entities. Accordingly, if a CSE chooses to expose itself to such risk, it should take steps to mitigate such risks."[21] Thus, MDBs are not the type of entities that the Commission had in mind when it proposed the "financial entity" definition in the first place – both because MDBs use swaps for hedging purposes and because MDBs do not present material risks to our counterparties, as discussed in more detail above.

Financial Entity – MDB Pension Plans

As a distinct point, we note that the proposed definition of "financial entity" includes "[a]n employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974". The employee benefit plans of the World Bank – which cover IBRD, IFC, IDA, and the Multilateral Insurance Guaranty Agency – technically fall within this description, since they are plans as defined in the relevant paragraphs of ERISA. Of course, the World Bank employee benefit plans – as well as the pension plans maintained by other MDBs – are not subject to regulation under ERISA, given our privileges and immunities. More broadly, IBRD holds legal title to the assets of the employee benefits plans, and these plans are covered by the privileges and immunities of IBRD in all respects. Accordingly, consistent with the reasoning set forth in the Entity Definitions Release and the Clearing Release, we seek confirmation from the Commission that the employee benefit plans of MDBs will not be considered "financial entities" for purposes of the proposed margin rules or any other rules issued in implementation of Title VII of the Dodd-Frank Act.

U.S. Person

Finally, we believe that the Commission should explicitly exclude IBRD, IFC, and the other MDBs from the definition of "U.S. Person" for all Title VII purposes.[22]

The Commission has already taken the view that IBRD is not a "U.S. person" in another context.[23] Other regulatory agencies such as the Securities and Exchange Commission have taken

[19] "Swap Data Recordkeeping and Reporting Requirements," 77 Fed. Reg. 2136, under the terms of which a financial entity must report when dealing with a non-financial entity. If MDBs are considered to be financial entities, they would arguably be subject to reporting requirements when entering into transactions with non-financial entities, which would be inconsistent with the privileges and immunities of MDBs, as discussed above, and in our previous comment letter and the Sullivan & Cromwell opinion.

[20] http://www2.isda.org/dodd-frank-documentation-initiative/ See Questionnaire to the Protocol, Part III, §5.

[21] 76 Fed. Reg. 23735.

[22] "Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act", 77 Fed. Reg. 41218 ("Proposed Interpretation of the Term U.S. Person").

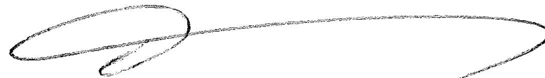
[23] CFTC Interpretative Letter regarding World Bank Group, Oct. 30, 1991, cited in the Clearing Release at footnote 16 ("Based on the unique attributes and status of the World Bank Group as a multinational member agency, . . . the CFTC believes that the World Bank Group need not be treated as a U.S. person for purposes of application of the CFTC's Part 30 rules.").

a similar view, for example in the definition of "U.S. Persons" set forth in Regulation S.[24] Furthermore, the exclusion of MDBs in general, and IBRD and IFC in particular, from the definition of U.S. Person in the context of Title VII would be a logical extension of the principles set forth in the Entity Definitions Release and the Clearing Release in respect of MDBs. This action would eliminate potential situations in which IBRD, IFC, or another MDB could be arguably subject to a direct reporting mandate, for example in a swap transaction between IBRD and an overseas entity that is neither a swap dealer or major swap participant, where only the relevant MDB would arguably considered to be a U.S. Person. This would also eliminate a potential situation in which entities that otherwise have no U.S. connection could be required to register as commodity pool operators solely because of transactions with IBRD, IFC, or another MDB.

7. *Conclusion*

We appreciate the fact that the Commission has recognized the special status of IBRD, IFC, and the other MDBs in its decisions to date in respect of the implementation of Title VII of the Dodd-Frank Act, and respectfully request a similar resolution of the margin rules and definitional issues discussed above.

Sincerely,



Anne-Marie Leroy
Senior Vice President and Group General Counsel
World Bank

Rachel Robbins
Vice President and General Counsel
International Finance Corporation

Attachments

cc: Mr. Gary Gensler, CFTC Chairman
Ms. Jill E. Sommers, CFTC Commissioner
Mr. Bart Chilton, CFTC Commissioner
Mr. Scott D. O'Malia, CFTC Commissioner
Mr. Mark P. Wetjen, CFTC Commissioner

[24] 17 C.F.R. §230.902(k)(2)(vi).

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July 22, 2011

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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)

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

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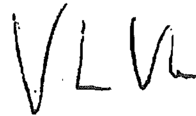
[5] Beyond lowering borrowing costs and providing risk management solutions to clients, the use of derivatives by MDBs also allows them to further the development of local bond markets and long-term local currency loans, both of which are priorities of the G20.

[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.

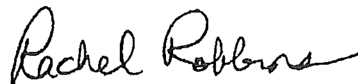
IBRD and IFC have already met with some of the Commissioners and their staff regarding the Dodd-Frank Act, and we would welcome the opportunity to engage in further consultations about any other potential implementations options that the Commissioners or the staff believe would be appropriate in the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

Sincerely,



Vincenzo La Via,
World Bank Group Chief Financial Officer

Anne-Marie Leroy
Senior Vice President and Group General Counsel



Rachel Robbins
Vice President and General Counsel, IFC

cc: Mr. Ian Solomon, Executive Director for the United States of America, The World Bank
Ms. Madelyn Antoncic, Vice President and Treasurer, The World Bank
Mr. Jingdong Hua, Vice President, Treasury and Information Technology, International Finance Corporation
Mr. Soren Elbech, Treasurer, Inter-American Development Bank
Mr. Pierre Van Peteghem, Group Treasurer, African Development Bank
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)).

The World Bank
Washington, D.C. 20433
U.S.A.

Anne-Marie Leroy
Senior Vice President and Group General Counsel

October 5, 2011

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

International Bank for Reconstruction and Development
and International Finance Corporation –
Legal Opinion Regarding Privileges and Immunities

Dear Mr. Chairman:

We met with you and your staff on July 6, 2011 to discuss the special status under U.S. law of the International Bank for Reconstruction and Development (IBRD), the International Finance Corporation (IFC), and other multilateral development institutions in which the United States is a member (collectively, the MDBs). In particular, we urged the CFTC to implement Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in a manner that (1) fully respects the privileges and immunities of IBRD, IFC, and other MDBs, as implemented in U.S. law, and (2) does not impair the development effectiveness of these institutions. We subsequently filed a July 22, 2011 comment on the proposed rule regarding the further definition of the term "swap", a copy of which is attached for your reference.

In our July 6 meeting, you asked if an external law firm had opined on this matter. IBRD and IFC subsequently commissioned the firm of Sullivan & Cromwell to analyze the potential application of the Dodd-Frank Act to our derivatives activities. The opinion was primarily prepared by Edwin Williamson, currently Senior Counsel to Sullivan & Cromwell and formerly the Legal Adviser of the U.S. Department of State. The Sullivan & Cromwell opinion, which is attached to this letter, confirms that regulation of IBRD and IFC under Title VII of the Dodd-Frank Act would constitute a breach by the United States of its international obligations under the Articles of Agreement of each organization, as implemented in U.S. law by the Bretton Woods Agreements Act and the International Finance Corporation Act. The opinion further concludes that the Dodd-Frank Act does not authorize any such curtailment of the privileges and immunities of IBRD and IFC.

The legal opinion is addressed to and focuses on the privileges and immunities of IBRD and IFC, the organizations that commissioned it. As noted in July 22, 2011 letter, all of the other MDBs (as defined therein) have equivalent privileges and immunities that

the US has agreed to accept (page 4) and which are implemented in U.S. law in the same manner as the privileges and immunities of IBRD and IFC (page 4, footnote 2).

As outlined in the July 22, 2011 letter, we continue to believe 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 (subject to a potential exclusion that would ensure that our commercial counterparties still report any transactions with us to the CFTC).

At the same time, we remain open to other options that would provide a comprehensive solution to this issue – in particular, solutions that would deal with what the Sullivan & Cromwell opinion describes as prohibited "Direct Regulation Equivalent" measures such as mandatory collateralization and clearing requirements for our derivatives transactions.

Please feel free to share this letter with the staff of the CFTC as you see fit, and to make it part of the public record as necessary or desirable. We would welcome the opportunity to engage in further consultations about any other potential implementation options that the Commissioners or the CFTC staff believe would be appropriate in the circumstances.

Sincerely,

Anne-Marie Leroy
Senior Vice President and Group General Counsel

cc: Mr. Michael Dunn, CFTC Commissioner
Ms. Jill E. Sommers, CFTC Commissioner
Mr. Bart Chilton, CFTC Commissioner
Mr. Scott D. O'Malia, CFTC Commissioner
Mr. Ian Solomon, Executive Director for the United States of America, World Bank
Mr. Vincenzo La Via, World Bank Group Chief Financial Officer
Ms. Madelyn Antoncic, Vice President and Treasurer, World Bank
Ms. Rachel Robbins, Vice President and General Counsel, IFC
Mr. Jingdong Hua, Vice President, Treasury and Information Technology, International Finance Corporation
Mr. Soren Elbech, Treasurer, Inter-American Development Bank
Mr. Pierre Van Peteghem, Group Treasurer, African Development Bank
Mr. Thierry De Longuemar, Treasurer, Asian Development Bank
Ms. Isabelle Laurent, Deputy Treasurer & Head of Funding, European Bank for Reconstruction & Development
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October 5, 2011

Anne-Marie Leroy
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International Bank for Reconstruction and Development
1818 H Street, NW
Washington, DC 20433

Rachel Robbins
Vice President and General Counsel
International Finance Corporation
2121 Pennsylvania Avenue, NW
Washington, DC 20433

Re: Privileges and Immunities of the International Bank for Reconstruction and Development and the International Finance Corporation

Dear Ms. Leroy and Ms. Robbins:

You have asked us whether the application to the International Bank for Reconstruction and Development ("IBRD") and the International Finance Corporation ("IFC") (collectively, the "Organizations") and the derivatives transactions to which they are a party ("swaps") of the regulations proposed or adopted by the Commodity Futures Trading Commission ("CFTC")[1] implementing Title VII of the Dodd-Frank Act (17 C.F.R. Parts 1, 23, 41, 190, 240) (the "Regulations") would violate the privileges and immunities provided to the Organizations by their respective Articles of Agreement and implemented as U.S. domestic law by the Bretton Woods Agreements Act in 1945

1 Because we understand that the Organizations do not engage in "security-based swaps", we are only addressing regulation by the CFTC. Were the Organizations to engage in "security-based swaps", our conclusions would also apply to the counterpart "security-based swaps" regulations of the Securities and Exchange Commission.

(22 U.S.C. § 286 (2006)) and the International Finance Corporation Act in 1955 (22 U.S.C. § 282 (2006)) (the "Implementing Legislation").

For the reasons and subject to the discussion below, in our opinion, such application of the Regulations would be a breach by the United States of its obligations under the Articles of Agreement. Furthermore, the effect of the Implementing Legislation is to prohibit any curtailment of the IBRD's and the IFC's privileges and immunities provided by the Articles of Agreement, in the absence of legislation authorizing such curtailment. The Dodd-Frank Act does not contain any such provision, express or implied.

I. The Basis of the Organizations' Privileges and Immunities

A. The Articles of Agreement and the Implementing Legislation

Article VII of the IBRD Articles of Agreement and Article VI of the IFC Articles of Agreement include the following privileges and immunities: (i) immunity from suit by or on behalf of member states (Section 3 of Articles VII and VI) ("immunity from members' suits"), (ii) immunity from attachment prior to entry of a final judgment (Section 3) ("attachment immunity"), (iii) immunity of their property and assets from "search, requisition, confiscation, expropriation or seizure *by executive or legislative action*" (Section 4) ("immunity from seizure"), (iv) inviolability of their archives (Section 5) ("archival immunity") and (v) "to the extent necessary to carry out the operations [of the Organizations as] provided for in" their respective Articles of Agreement, freedom of their property and assets from "*restrictions, regulations, controls* and moratoria of any nature" (Section 6) ("regulatory immunity") (emphasis added). The express purpose of the privileges and immunities is "to enable the [Organizations] to fulfill the functions with which [they are] entrusted...." (Section 1 of IBRD Article VII and IFC Article VI.)

The Articles of Agreement obligate all member governments to accept and implement the privileges and immunities espoused in the Articles of Agreement into domestic law (Section 10 of IBRD Article VII and IFC Article VI). The United States executed these obligations by passing the Implementing Legislation, which expressly provides that the Articles of Agreement have "full force and effect in the United States and its Territories and possessions" (22 U.S.C. § 286(h) (2006); 22 U.S.C. § 282(g) (2006)).

B. The International Organizations Immunity Act

The International Organizations Immunity Act ("IOIA") provides that the property and assets of international organizations designated by the President of the United States "shall enjoy the same immunity from suit and every form of judicial process as is enjoyed by foreign governments" and "shall be immune from search" and "confiscation" (22 U.S.C. §288a(b),(c)). It also provides that the archives of such organizations are inviolable. Id. The Organizations have been designated by the President as enjoying the provisions of the IOIA (Exec. Order No. 9751, 3 C.F.R. 558 (1943–1948; Exec. Order No. 10,680, 21 Fed. Reg. 7,647 (Oct. 2, 1956)).

The IOIA is not as broad as the Articles of Agreement and the Implementing Legislation in its grant of privileges and immunities. It does, however, supplement and reinforce certain of the privileges and immunities accorded to the Organizations under their Articles of Agreement and the Implementing Legislation. To the extent that the provisions of IOIA and the Articles of Agreement are not identical, the Organizations enjoy the benefits of both (Restatement of the Foreign Relations Law of the U.S., § 467, comment f (1988)). Thus, interpretations of the IOIA are instructive in understanding the privileges and immunities accorded by the Articles of Agreement. The IOIA immunities may be denied by Presidential action, but the President does not have similar authority under the Articles of Agreement and the Implementing Legislation.

C. Purposes of the Privileges and Immunities

The premises on which the Organizations' immunities – and indeed, the Articles of Agreement as a whole – are based are that (i) some measure of immunity from the legislation and application of individual sovereign rules is necessary if the Organizations are to effectively operate in an international environment and fulfill their development missions and (ii) the Articles of Agreement create a single collective governance system through which the sovereign members of the Organizations control the Organizations and through which appropriate rules and practices, such as financial controls, employment rules and financial disclosure practices, are imposed by the members. As the largest shareholder and capital contributor of the Organizations, the United States plays a very important role within this structure.

Consistent with these premises, the Organizations have functioned for decades free from national regulatory regimes. The United States has confirmed on several occasions that the Organizations are not subject to U.S. financial regulations: (i) the securities of the Organizations are not subject to the provisions of the Securities

Act of 1933 and the Securities Exchange Act of 1934 (22 U.S.C. § 282k(a) (2006); 22 U.S.C. § 286k-1(a) (2006)); (ii) the staff of the Securities and Exchange Commission ("SEC") has confirmed that the status of the IFC under its Articles of Agreement "is obviously completely inconsistent with the broad jurisdiction" of the SEC under the Investment Company Act of 1940 (Memorandum from the Division of Corporate Regulation to the SEC Re: Applicability of the Investment Company Act of 1940 to the International Finance Corporation (May 10, 1955) (on file with the SEC)); and (iii) the SEC has confirmed that the IBRD and the International Development Agency "are persons not within the intent" of the Investment Advisers Act of 1940's definition of "investment adviser" (Investment Advisers Act of 1940 Release No. 1971, 2001 SEC LEXIS 1782 (Sept. 4, 2001)). The European Commission has similarly exempted the Organizations from the reach of its Prospectus Directive and Transparency Directives (Council Directive 2003/71, para. 11, 2003 O.J. (L 345) (EC); Council Directive 2004/109, art. 8, 2004 O.J. (L 390) (EC)), as have the European Parliament and Council in the Alternative Investment Fund Managers Directive (Council and Parliament Directive 2011/61, art. 2, 2011 O.J. (L 174)).

Although there are relatively few court decisions interpreting the scope of the privileges and immunities of international organizations, and we have not found a case that is directly on point with the facts and circumstances that you have asked us to consider, the privileges and immunities of international organizations have been considered by courts and the executive branch in other regulatory contexts. For example, courts and the executive branch have confirmed that national employment laws do not apply to the Organizations. In Mendaro v. World Bank, 717 F.2d 610 (D.C. Cir. 1983), the court held that the IBRD was immune from an employment related suit under the IOIA. The court cited approvingly a 1980 letter from the State Department Legal Adviser to the General Counsel of the Equal Employment Opportunities Commission. Id. at 620. That letter stated: "[T]here has emerged a widespread practice among States not to exercise jurisdiction over internal employment disputes in international organizations, regardless of whether national law specifically provides for immunity from jurisdiction...[o]ur own practice ... has been in accord with this principle, and I believe that it is incumbent on the U.S. Government to ensure that it remains so." (Marian L. Nash, *U.S. Practice*, 74 A.J.I.L. 917, 919-20 (1980)). The Mendaro court also relied on its decision in Herbert Harvey, Inc. v. NLRB, 424 F.2d 770 (D.C. Cir. 1969), in which the court acknowledged the IBRD's immunity from the jurisdiction of the National Labor Relations Board, in holding that a supplier of maintenance building services was nevertheless subject to the NLRB's jurisdiction, because the employees were not "intimately connected" to the IBRD's operations. The court's opinion suggests that, had the supplier supplied services that were "connect[ed] with the functions of the World

Bank as an investment institution", both it and the NLRB would have found that the supplier was not subject to the NLRB's jurisdiction because of the IBRD's immunity. Id. at 782.

A key element in the rationale underlying the conclusions in the authorities cited in the previous paragraph is the necessity that international organizations be free from hindrance by individual member states. In holding the Organization of American States immune from an employment contract claim in Broadbent v. OAS, 628 F.2d 27 (D.C. Cir. 1976), the court said: "[t]he United States has accepted without qualification the principles that international organizations must be free to perform their functions and *that no member state may take action to hinder the organization*. . . . Undercutting uniformity in the application of staff rules or regulations would undermine the ability of the organization to function effectively." Id. at 34-35 (emphasis added). In supporting its holding, along this same line of reasoning, the Mendaro court included the following quotation from the State Department Legal Adviser's letter referred to in the preceding paragraph: "Forcing the organizations to conform their personnel practices to the varying – and often conflicting – domestic laws in each country where they operate would create unmanageable administrative burdens and could well prevent them from carrying out the functions for which they were created." Mendaro, 717 F.2d at 617.

II. The Dodd-Frank Act Does Not Repeal or Provide Authority for the Curtailment of the Organizations' Privileges and Immunities

A. Canons of Statutory Interpretation Dictate that Repeal or Curtailment of Privileges and Immunities Must Be Explicit

The Organizations' privileges and immunities are established by their Articles of Agreement, which are international agreements to which the United States is a party. They have been made part of the domestic law of the United States by an act of Congress. The relevant canons of statutory interpretation compel the conclusion that the Dodd-Frank Act did not, and it did not authorize the CFTC to, repeal or curtail the Organizations' privileges and immunities found in the Articles of Agreement.

1. *Generalia specialibus non derogant* ("the general do not derogate from the specific") is a long-recognized canon of statutory interpretation. It essentially holds that if a later general law and an earlier specific law are potentially in conflict, courts will adopt the reading that does not result in an implied repeal of the earlier statute absent an express indication that the legislature intended to repeal the earlier law. In Ex Parte Crow Dog, 109 U.S. 556, 572 (1883) (superseded by statute on other grounds), the United

States Supreme Court held that a subsequent treaty with Native Americans did not repeal a prior law that excepted Native Americans from the jurisdiction of U.S. courts for specified acts, since the subsequent treaty did not repeal the prior statute through express words or necessary implication. The court explained that "[t]o find [that the later treaty repealed the more specific prior statute] would be to reverse in this instance the general policy of the government towards the [Native Americans], as declared in many statutes and treaties, and recognized in many decisions of this court, from the beginning to the present time. To justify such a departure, in such a case, requires a clear expression of the intention of Congress, and that we have not been able to find." Id.

Another example of the application of this canon can be found in General Electric Credit Corp. v. James Talcott, Inc., 271 F. Supp. 699 (S.D.N.Y. 1966), which held that the venue rules under the later adopted Securities Act of 1933 and the Securities Exchange Act of 1934 do not apply to national banks, which are governed by the more specific venue rules of the National Bank Act, since (i) there is a presumption against implied repeals, (ii) a special earlier statute is deemed to remain in existence as an exception to a later inconsistent more general statute and (iii) no irreconcilable conflict existed between the two venue statutes if the prior canon of statutory interpretation were applied.

Thus, the Organizations' specific privileges and immunities must be read as exceptions to the reach of the later adopted Dodd-Frank Act's general and broad provisions that, read literally, seemingly would require the regulation of all entities engaging in derivative transactions. Any other conclusion would amount to an implied repeal of the Organizations' immunities, a violation of the *generalia specialibus non derogant* maxim, given that the conflict between the seemingly expansive reach of the Dodd-Frank Act and the expressly provided privileges and immunities of the Organizations is irreconcilable. To paraphrase Ex Parte Crow Dog, a finding that the later enacted general Dodd-Frank Act effectively repeals, or authorizes the CFTC to repeal, a more specific prior law "would be to reverse in this instance the general policy of the government towards [the Organizations] from the beginning to the present time." 109 U.S. at 572. As discussed in more detail below, Congress has not expressed a clear intention, in either the text of Title VII or its legislative history, to do so.

2. The "*Charming Betsy* canon" holds that "[A]n act of Congress ought never to be construed to violate the law of nations if any other possible construction remains" (McCullough v. Sociedad Nacional de Marineros de Honduras, 372 U.S. 10, 19 (1963) (quoting Murray v. Schooner Charming Betsy, 6 U.S. 64, 118 (1804))). The Restatement of the Foreign Relations Law of the U.S., §114 (1988) formulates the

Charming Betsy canon this way: "Where fairly possible, a United States statute is to be construed so as not to conflict with international law or with an international agreement of the United States." In McCullough, the United States Supreme Court used this canon of interpretation to hold that federal law did not apply to a foreign vessel with American contacts where (i) a well-established rule of international law would require that a different law control, (ii) no language existed in either the federal act itself or in its "extensive legislative history" that reflected an intent to apply the federal law to foreign vessels and (iii) questions of international import would remain as to invite retaliatory action from other sovereigns if the federal law were applied. McCullough, 372 U.S. at 19-22.

* * *

Thus, in the absence of any indication that Congress intended otherwise, the Dodd-Frank Act must not be interpreted in a way that would result in the violation of the domestic law of the United States established by the Implementing Legislation or in the violation by the United States of its international law obligations contained in the Organizations' Articles of Agreement.

B. There is No Indication that the Dodd-Frank Act was Intended to Apply to the Organizations, Either Directly or Indirectly

The legislative history of Title VII and the historical national and international treatment of the Organizations suggest that Title VII should not apply to them. The record is void of any indication that Congress intended for Title VII of the Dodd-Frank Act to apply to the Organizations. Nothing in either the text of Title VII or its copious legislative history suggests a concern about regulating such entities. While the legislative history contains sporadic references to "international implementation" of the provisions of Title VII, the discussions appear to be more concerned with large, international, for-profit financial institutions rather than development institutions, such as the Organizations, that are owned by sovereign states. To the extent that the IBRD is ever referred to, it is only to mention it for its beneficial purpose. (Senator Dodd referred to the IBRD as "provid[ing] financial assistance and stability to nations that are struggling" in the context of speaking about *the fiscal irresponsibility of others* (111 Cong. Rec. S3860 (daily ed. May 18, 2010)).) Were there congressional intent to apply Title VII to the Organizations, such intent should have been expressly included in the Dodd-Frank Act itself and, we would expect, an explicit reference of such application to the IBRD or the IFC would have been expressed during the course of legislative deliberations.

While the text of Title VII also refers to the need for consistent "international implementation" of swaps regulation, this requirement as espoused in Section 752(a) of the Dodd-Frank Act lends further support to the proposition that Title VII should not apply to the Organizations. Section 752(a) of the Dodd-Frank Act requires the CFTC and the SEC to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation ... of swaps [and] security based swaps." The European Commission, however, has already considered the applicability of national derivative regulation to the Organizations in proposed legislation. Having done so, it concluded that such regulations should not apply to entities such as the Organizations, and it expressly provided that its European Market Infrastructure Regulation[2] – the European counterpart to Title VII – shall not apply to such entities "in order to avoid limiting their powers to intervene to stabilise [sic] the market, if and when required." (Explanatory Memorandum on Commission Proposal for a Regulation of the European Parliament and of the Council on OTC Derivatives, Central Counterparties and Trade Repositories, COM (2010) 484 (final) (Sept. 15, 2010).)

III. The Organizations' Purposes and Uses of Derivatives

The Organizations exist to promote economic development in their member countries. Envisioned at the Bretton Woods Conference in 1944 and established in 1945, the focus of the IBRD is on providing financing to its sovereign member countries. In 1956, the IFC was established with the stated goal of furthering economic development in the private sector through investments and other activities in the developing world. To realize their objectives, the Organizations employ a number of tools, including direct lending in major and local currencies, investing in equity in private sector enterprises and mobilizing from the private sector in order to supplement direct investment by the Organizations.

You have informed us that the Organizations use over-the-counter ("OTC") derivatives to hedge currency, interest rate and other market risks arising in connection with their lending, borrowing, equity management and investment operations, and to enable clients in developing countries and other official sector institutions to

[2] The European Commission's Regulation is currently pending before the European Parliament and the Council of the European Union.

manage the risks to which they are exposed as a result of their activities.[3] For example, the Organizations are able to borrow in currencies and interest bases that offer the lowest possible cost. Typically, interest rate or currency derivatives are used to hedge these liabilities into floating rate dollars, the basis on which the Organizations manage their assets. Interest rate and currency derivatives are used by the Organizations to manage their liquidity and for asset/liability management (e.g., to hedge mismatches between their floating rate dollar balance sheets and lending operations conducted in both major and emerging market currencies and at fixed and floating rates of interest). In furtherance of the Organizations' development objectives, they also make hedging tools available to their sovereign and private sector clients, doing so by engaging in back-to-back principal transactions that allow the Organizations to take the credit risk of their clients and bridge the credit gap preventing their clients from obtaining direct access to hedging markets, while simultaneously hedging any associated market risk with major international banks and swap dealers. These risk management transactions are part of a comprehensive suite of development financing tools that, in your view, are integral to the development operations of the Organizations, both as part of the Organizations' own tools for managing their funding, liquidity management and asset/liability management functions, and in providing needed access to financing strategies for the Organizations' sovereign and private sector clients. Indeed, you have advised us that, in your opinion, without access to derivatives markets, the Organizations could not operate effectively in a multi-currency, floating rate environment as they do today. The Organizations use derivatives for such hedging purposes as part of providing financing solutions to emerging market countries and do not engage in speculative transactions.

Furthermore, you advise, the Organizations have the necessary capabilities for managing the risks associated with over-the-counter derivatives, including transaction valuation tools and collateral management operations. In addition, both Organizations have established risk management procedures that set and monitor commercial counterparty credit exposure. The IBRD has been active in the derivatives market for three decades and has supported market initiatives to manage risk. Notably, both Organizations currently require even highly rated major market counterparties to collateralize trades undertaken with the Organizations. You have informed us that the strong practices of both Organizations have led them to be consistently rated as highly credit-worthy counterparties by credit rating agencies, and that banking regulators have

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[3] In rendering this opinion, we have relied, without independent verification, on information provided to us by the Organizations as to their swaps activities and the impact the application of the Regulations would have on their development missions.

consistently assigned low risk weightings to transactions with the Organizations under the Basel II framework.

A determination that the privileges and immunities of the Organizations do not insulate them from compliance with the provisions of the Dodd-Frank Act and the Regulations would impede the Organizations' abilities to effectively fulfill their functions by opening the door to the imposition of a multitude of national regulatory regimes on the Organizations. Regulation by several member states would inevitably result in conflicting regulation in many respects, which would hinder their ability to realize the international development objectives of their member governments, including the United States.

Finally, it is quite important to note that the Organizations are wholly owned by their sovereign shareholders; there are no equity shares held by individuals or financial institutions. Furthermore, there are no substantial bonuses or differential compensation arrangements that depend on financial performance. Thus, in your view, neither management nor staff of the Organizations has any individual or collective financial incentive to undertake undue risk.

IV. Application of the Regulations to the Organizations' Derivatives Would Violate their Privileges and Immunities

A. The Regulatory Scheme of the Regulations

There are basically two types of regulatory measures to which the Organizations and their swaps would be subject, were they to be covered by the Regulations, that would violate the Organizations' privileges and immunities:

1. *Direct Regulation of Entities under Title VII Based on Their Derivatives Activities ("Direct Regulation").* If the Organizations were covered by the Regulations, they could be required to register as "major swap participants" or "MSPs".[4] As an MSP, each would likely be required to, among other things:

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[4] Given the status of the Regulations as of the date hereof, particularly the definition of "swap dealer", we are not able to conclude that the Organizations' activities would cause them to come within the definition of "swap dealer". The regulatory measures that would apply to the Organizations if they were required to register as "swap dealers" would create substantially the same conflicts with the Organizations' privileges and immunities as those that would be imposed on them as MSPs.

(a) Prepare and retain books and records in such manner and for such period as may be prescribed by the CFTC and submit to examinations and investigations by the CFTC;

(b) Maintain daily trading records (including records of oral and electronic communications and recording telephone calls);

(c) Post collateral as security for its swap obligations;

(d) Comply with capital requirements prescribed by the CFTC;

(e) Execute its swaps on a designated contract market or swap execution facility and clear them through a derivatives clearing organization;

(f) Conform to specific business conduct standards as adopted by the CFTC;

(g) Conform its swaps documentation to the standards proscribed by the CFTC; and

(h) Establish other practices that would be monitored by the CFTC.

Failure to comply with these measures, if they were applicable, would, of course, subject the Organizations to enforcement action.

2. *Regulation of Derivatives Entered into by the Organizations with Regulated Entities ("Direct Regulation Equivalent").* Even if the Organizations are not required to register as MSPs, if their swap transactions are covered, then transactions with entities that are MSPs or "swap dealers" would subject the Organizations to several of the Direct Regulation measures. For example, the Organizations would be required to post collateral as security for their swap obligations and their swap transactions would be required to be executed on a designated contract market or swap execution facility and cleared through a derivatives clearing organization. The documentation would have to conform to standard documentation. This is in many ways the substantive equivalent of the Organizations' being subjected to Direct Regulation, as the Regulations would have the effect of requiring the Organizations to modify their current practices.

B. Why the Regulations Would Violate the Organizations' Privileges and Immunities

Our conclusions set forth below as to the scope of the privileges and immunities of the Organizations in the context of the Regulations are based on our reading of the Organizations' respective Articles of Agreement, and our understanding of the policies underlying the scope and purposes of the privileges and immunities of international organizations generally, as illustrated in applicable court decisions and regulatory actions, as discussed in Section I.C.[5]

In our view, the books and records requirements, as well as the CFTC's examination and investigative powers, would violate the Organizations' archival immunity. Being subject to enforcement action would violate their immunity from members' suits, as well as their immunity from searches.

The requirement that the Organizations post collateral would violate the Organizations' immunities from attachment and seizure, whether the requirement is imposed as a Direct Regulation or a Direct Regulation Equivalent measure. The Organizations' attachment immunity protects the Organizations' assets from an attachment before the entry of a final judgment. Posting collateral in order to enter into a transaction, particularly when there is no indication that the collateral will ever be called, is the economic equivalent of an attachment prior to a judgment having been entered. The Organizations' immunity from seizure protects the Organizations from any government's attempt to, among other things, requisition the Organizations' assets, such as by requiring that the Organizations use their assets in a prescribed manner. Likewise, requiring that the Organizations use their assets for a purpose other than for the furtherance of their development purposes is the economic equivalent of a requisition, even if it is for a limited purpose.

While the Organizations' regulatory immunity may appear to be less absolute and perhaps more conditional than the other immunities found in the Articles of Agreement, because their regulatory immunity provides freedom from regulation only

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[5] In light of the scarcity of authority, and the absence of controlling authority in this specific context, the scope of the privileges and immunities of the Organizations in this context is not entirely free from doubt. Nevertheless, we believe that a court, if presented with a properly pleaded and argued case, should agree with our conclusions as to their scope.

"[t]o the extent necessary to carry out the operations provided for" in the Articles of Agreement, we do not believe that this is the case as applied to the context that you have asked us to consider. As the authorities cited in Section I.C indicate, a key element to the immunities is the necessity of avoiding the imposition by member states of regulations that could hinder the Organizations' abilities to accomplish their stated purposes. While those authorities cited were dealing with immunities that did not contain the "to the extent necessary" clause, we do not believe that difference is significant in this context. Because the imposition of regulations by one member state could lead to the imposition of additional, or varying or even conflicting, regulations by other member states, we believe that any regulatory measures that, while not necessarily prohibiting essential activities, increase the costs of such activities, reduce their effectiveness, adversely affect uses of capital or encourage other members to attempt to regulate or impose controls on the Organizations violate the Organizations' regulatory immunity.

In addition, you have informed us that compliance with many of the Regulations would come at a substantial cost of capital, personnel and time, causing the Organizations to divert resources intended for clients in the developing world. As an alternative, it might be necessary for the Organizations to remove themselves from the larger marketplace and transact wholly with other exempt entities or limit their activities to jurisdictions where their activities are not regulated, at a substantial cost to their ability to effectively manage risk due to the exponentially smaller universe of available counterparties. Other alternatives would be for the Organizations to limit lending activities, to the detriment of prospective borrowers and their development mission, or to discontinue providing risk management tools to borrowing countries and other clients, leaving them exposed to interest rate and currency risks. All of these options would impede the development effectiveness of the Organizations.

V. Regulation of the Organizations or Their Swaps is not Necessary

As we indicate in Section I.C, one of the premises on which the Organizations' privileges and immunities are based is that their Articles of Agreement create a single collective governance system through which the sovereign members of the Organizations control the Organizations and through which appropriate rules and practices are imposed by the members. The use of derivatives by the Organizations is authorized, monitored and controlled by their sovereign members, including the United States, in accordance with the organizations' operative documents. Thus, not only is there no need for a country-specific layer of regulation, but if the United States were to regulate the Organizations under the Dodd-Frank Act, it would open the door to other individual member states imposing their own regulations. This would undercut the

Organizations' governance system, which is based on the participation of each member government in the collective system as the exclusive method of governance.

For approximately thirty years, the Organizations have effectively managed their derivative operations independent of individual sovereign regulation. Given their history of responsible risk management, the fact that the Organizations' swaps are not regulated under Title VII would not create systemic risk or materially limit the CFTC's ability to regulate the market. (The Organizations' counterparties would, of course, continue to be regulated, to the extent that they are MSPs or swap dealers.) On the other hand, if the Organizations – both of which are very credit-worthy, responsible risk managers with strong capital structures backed by sovereign shareholders – are forced by the Regulations to withdraw from the larger swap market, it would leave fewer highly rated swap counterparties to transact with. Such a result may prove to be squarely inconsistent with Title VII's underlying concern about limiting systemic market risk.

It is also important to note that there is nothing to prevent the Organizations from voluntarily complying with provisions of Title VII, if the Organizations conclude that such actions are financially efficient and consistent with their development mandates. In any event, the history of responsible risk management by the Organizations and the overall mission of the Organizations helps to give comfort that the Organizations are unlikely to engage in the offending practices that Title VII was intended to curtail. Furthermore, the United States and the other member states, through their role in the Organizations' governance structures, should be able to prevent the Organizations' engagement in such practices.

With respect to Title VII's margin requirements, which you have advised us would be particularly burdensome to the Organizations, it is of note that each of the Organizations' ISDA agreements with counterparties, under which its swaps are entered into, contains a provision obligating the Organization to post collateral if its credit rating is downgraded below triple-A. (Currently, the Organizations are not required to post collateral.) Accordingly, the protections that Title VII seeks to impose in this regard are already built into the Organizations' contractual agreements. The Organizations' governance structures provide the member governments with a vehicle for maintaining these protective measures.

VI. Conclusion

The Direct Regulation and the Direct Regulation Equivalent measures may not apply to the Organizations or their swap transactions, because (i) such

application would be inconsistent with the Organizations' broad privileges and immunities provided in their Articles of Agreement, (ii) the United States has adopted implementing legislation giving full force to these privileges and immunities as domestic law of the United States and (iii) such application would violate the international obligations of the United States. Moreover, nothing in the text of Title VII of the Dodd-Frank Act or its extensive legislative history suggests that the Organizations or their swaps were intended to be subject to the requirements of Title VII. We also note your concern that inclusion of the Organizations and their swap transactions in the regulatory structure prescribed by the Dodd-Frank Act regarding derivative transactions is unnecessary in light of the governance structures of the Organizations, and that subjecting the Organizations or their swaps to regulation would likely have substantial negative consequences for the Organizations and their clients.

This opinion is addressed to you, is solely for your benefit and may not be relied upon by any other person without our express written consent.

Very truly yours,

SULLIVAN & CROMWELL LLP

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May 17, 2012

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Re: Title VII of the Dodd-Frank Act
– Proposed Release Regarding Further Definition of:
"Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant,"
"Major Security-Based Swap Participant," and "Eligible Contract Participant"
(the "Proposed Release")

Dear Mr. Stawick and Ms. Murphy:

We would like to express our appreciation for the positive decisions the CFTC and the SEC made on the proposed definitions of "swap dealer" and "major swap participant" in the Proposed Release – in particular, the determination that multilateral development banks should not be required to register as swap dealers or major swap participants.

We are, however, concerned that there are a couple of technical issues in the Proposed Release that could lead to confusion in the future. While we agree with the statement in the text accompanying footnote 1182 in the Proposed Release that "foreign entities are not necessarily immune from U.S. jurisdiction for commercial activities undertaken with U.S. counterparties or in U.S. markets", we do not believe that that statement applies to our organizations or the other "multilateral development banks" referred to in footnote 1180 of which the United States is a member (the "MDBs"). The immunity of the MDBs from suits by member states (and persons acting on their behalf) and from member state regulation is specifically provided for in their respective Articles of Agreement, which are international agreements binding on the United States and which have been enacted into U.S. domestic law. The MDBs' immunity from suit and regulation by member states is not affected by whether they engage in commercial activities (which they do engage in). As the Proposed Release correctly points out in, in the text accompanying footnotes 1184 and 1185, there is nothing in the text or history of Title VII to indicate that Congress intended to repeal those immunities. As a result, the sentence accompanying footnote 1183 ("Registration and regulation as a swap dealer or major swap participant under such circumstances may be warranted.") is incorrect if applied to the MDBs.

Furthermore, we do not believe that the holdings in Mendaro, Osseiran and Vila, cited in footnote 1182 of the Proposed Release, support the conclusion in the text accompanying footnote 1182, which is quoted in the previous paragraph, particularly if applied to the MDBs. Those

cases dealt with the MDBs' immunity from suits by private parties and did not deal with their immunity from suits by member states or their regulatory immunity.

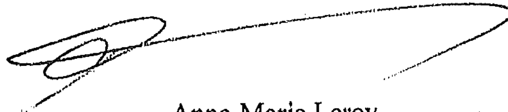
Therefore, we would like to propose that the following technical changes be made in the Proposed Release before it is submitted for publication in the Federal Register:

1. The second sentence of footnote 1182, consisting solely of citations and summaries of Mendaro, Osseiran and Vila, should be deleted from footnote 1182. Were it not for the references to the MDBs in the summaries of those cases, the paragraph accompanying footnote 1182 would not be read as applying to the MDBs. The suggested deletion would make this clearer.

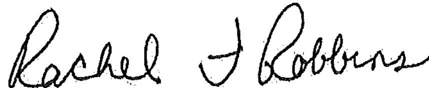
2. There should be added to footnote 1185 (or inserted in a new footnote) something along the following lines: "Under their respective Articles of Agreement, the "multilateral development institutions" defined as such in 22 U.S.C. §262r(c) (3) are immune from suit and regulation by member states."

We thank you for your attention to this matter.

Sincerely,



Anne-Marie Leroy
Senior Vice President and Group General Counsel
World Bank



Rachel Robbins
Vice President and General Counsel
International Finance Corporation

cc: Office of General Counsel, Commodity Futures Trading Commission:
Jeffrey P. Burns, Assistant General Counsel
Mark Fajfar, Assistant General Counsel
Julian E. Hammar, Assistant General Counsel
David E. Aron, Counsel

Division of Trading and Markets, Securities and Exchange Commission:
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Richard Grant, Special Counsel
Richard Gabbert, Attorney Advisor