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Robert E. Feldman, Executive Secretary
Attention: Comments
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May 24, 2013 JU/JU CORP/FI/2013-1339/RS/sldg

Re: Request for the Exclusion of OTC Derivatives with Multilateral Development Banks from the CVA Capital Requirement

Ladies and Gentlemen:

We are submitting this letter in support of certain comments made on the Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule ("Advanced Approaches NPR"), 77 Fed. Reg. 52,978 (Aug. 30, 2012), issued by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), and the Federal Deposit Insurance Corporation ("FDIC") (collectively, the "Agencies"). While we recognize that the comment period for the Advanced Approaches NPR has closed, we wish to express our support for those commenters who recommended that the Advanced Approaches NPR be modified to provide an exclusion for multilateral development bank ("MDB") counterparties from the credit valuation adjustment ("CVA") provisions.

Two comment letters — one submitted jointly by the American Bankers Association, the Securities Industry and Financial Markets Association, and the Financial

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Services Roundtable,[1] and another submitted jointly by The Clearing House and the American Securitization Forum[2] — directly requested that an exemption for MDB counterparties be added to the CVA provisions in light of the minimal risk presented by such entities and in order to avoid conflicting capital treatment of MDBs in the proposed and final capital rules within the United States.[3]

Additionally, the World Bank, on behalf of MDBs in which the United States is a member, submitted its own letter in which it "question[ed] the applicability of the CVA capital charge to transactions with MDBs."[4] In its letter, the World Bank stated that "[g]iven the essentially riskless status of credit exposures to MDBs ... [and the fact that] MDBs do not generally exhibit substantial credit volatility, and are not the subject of credit default swaps ("CDS"), ... there is no strong empirical basis for developing ... CVA charges for transactions with MDBs."[5]

Finally, JPMorgan Chase & Co. submitted a letter requesting that sovereigns, pension funds, and corporate counterparties be excluded from CVA market risk calculations to ensure consistent treatment of such parties within the capital frameworks of the United States and European Union ("EU").[6]

Consistent with the views of these commenters, the European Investment Bank ("EIB") respectfully requests that the Agencies exclude OTC derivatives with MDBs from the CVA capital requirements because of the low credit risk of exposure to such entities,

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1 *See* Comment Letter from the American Bankers Association, the Securities Industry and Financial Markets Association, and the Financial Services Roundtable on Proposals to Comprehensively Revise the Regulatory Capital Framework for U.S. Banking Organizations (Oct. 22, 2012), *available at* http://www.federalreserve.gov/SECRS/2012/December/20121206/R-1442/R-1442_102212_110014_386243203248_1.pdf.

2 *See* Comment Letter from The Clearing House and the American Securitization Forum on Regulatory Capital Rules (Oct. 22, 2012), *available at* http://www.c.federalreserve.gov/SECRS/2012/December/20121213/R-1442/R-1442_102312_109652_373891000684_1.pdf.

3 The Agencies issued three proposed capital rules on August 30, 2012: (1) Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action ("Basel III Numerator NPR"), 77 Fed. Reg. 52,792; (2) Standardized Approach for Risk-Weighted Assets; Market Discipline and Disclosure Requirements ("Standardized Approach NPR"), 77 Fed. Reg. 52,888; and (3) the Advanced Approach NPR (collectively, the "Proposals"). The Agencies also issued a final rule on the same day. *See* Risk-Based Capital Guidelines: Market Risk, 77 Fed. Reg. 53,060 (Aug. 30, 2012) ("Market Risk Final Rule").

4 Comment Letter from the World Bank on the Proposed Rule Entitled "Margin and Capital Requirements for Covered Swap Entities," at 9 (Nov. 26, 2012), *available at* http://www.federalreserve.gov/SECRS/2012/November/20121130/R-1415/R-1415_112612_110877_688136176592_1.pdf.

5 *Id.* at 9.

6 *See* Comment Letter from JPMorgan Chase & Co. on the Joint Notice of Proposed Rulemakings (Oct. 22, 2012).

and in order to ensure consistency in the treatment of MDBs within proposed and final capital rules in the United States, as well as with the EU's capital framework.

I. The European Investment Bank

A. Background

The EIB is an autonomous public institution operating on a non-profit-making basis, comparable with other development banks known in the parlance of the U.S. Commodity Futures Trading Commission ("CFTC") as "international financial institutions."[7]

The EIB, owned entirely by the Member States of the EU, is the financing institution of the EU. It was created in 1958 under the original Treaty of Rome, and remains authorized under the Treaty on EU and the Treaty on the Functioning of the EU, amending the Treaty of Rome. It is constituted pursuant to the Statute of the European Investment Bank (the "Statute"). The Statute, as amended, is set out in a Protocol annexed to the Treaty on the Functioning of the EU. As an annexed Protocol, the Statute is an integral part of, and has the same legal force as, the Treaty.

The EIB's mission is to foster the balanced and steady development of a common market among Member States. To that end the EIB focuses on co-financing projects by working with banks as well as corporate and public-sector project promoters in the less-developed regions of the EU. To fulfill this purpose the EIB provides financing, in particular in the form of loans and guarantees, for projects that foster economic cohesion and convergence and in areas that include promotion of environmental sustainability and that provide support for sustainable, competitive, and secure energy.

To a more limited extent, the EIB also provides funding for certain development projects outside the EU, accounting for approximately 10% of the EIB's portfolio. Activities outside the EU are devoted to emerging economies, notably EU- candidate countries, neighboring countries such as Russia and other countries on the EU's eastern perimeter, Mediterranean partner countries, and Asian, African, Latin American, Caribbean, and Pacific countries. Projects in these areas support development of private sector enterprises, the financial sector, infrastructure, secure energy supply, and environmental sustainability.

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[7] For CFTC use of the term "international financial institution," including explicit listing of EIB, *see* End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42560, 42561-62 n.14 (July 19, 2012) (Final Rule); *see also* Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement," Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48208, 48303 n. 1070 (Aug. 13, 2012) (Joint Final Rule); Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 Fed. Reg. 30596, 30692 n. 1180 (May 23, 2012) (Joint Final Rule) (defining "international financial institution" for the purpose of concluding that Congress did not intend to include such entities within the definition of "major swap participant").

B. Ownership, Governance, and Financing Activity

The EIB is owned entirely by the Member States of the EU. The Member States subscribe to the EIB's capital. Generally, each member's share is based on its economic weight within the EU (as expressed by gross domestic product) at the time of its accession.

Pursuant to the Statute, the EIB is governed by a 27 member Board of Governors, each of whom is designated by a Member State of the EU. They are, primarily, the Finance Ministers of the EU Member States. The Board of Governors approves the overall strategy of the EIB, establishes credit policy guidelines, approves the annual account and balance sheet, makes decisions on capital increases and approves activities outside the EU. The Board of Governors also appoints the 28 members of the Board of Directors on nomination by the Member States and the European Commission. The Board of Directors has sole power to make decisions on loans, guarantees, and borrowings. It is also responsible for ensuring that the EIB operates within the parameters of the Treaty and Statute. The Board of Governors also appoints a Management Committee and a six-person Audit Committee. Thus, the EU Member States retain a high degree of oversight over the EIB's financial status and operations.

By Treaty and under its Statute, the EIB is to operate as a non-profit entity. Its mission is to finance sound projects (and not speculative activities), as stipulated in Article 309 (ex Article 267 TEC) of the Treaty on the Functioning of the EU:

> The task of the European Investment Bank shall be to contribute, by having recourse to the capital market and utilising its own resources, to the balanced and steady development of the internal market in the interest of the Union. For this purpose the Bank shall, operating on a *non-profit-making basis*, grant loans and give guarantees which facilitate the financing of the following projects in all sectors of the economy: (a) projects for developing less-developed regions; (b) projects for modernising or converting undertakings or for developing fresh activities called for by the establishment or functioning of the internal market, where these projects are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States; (c) projects of common interest to several Member States which are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States (emphasis added).

In addition, pursuant to the Statute, the EIB's treasury activities are not oriented toward speculative trading or the pursuit of profit. In fact, as reflected in Article 21 of the Statute "the *Bank shall not, in managing its investments, engage in any currency arbitrage* not directly required to carry out its lending operations or fulfill commitments arising out of loans raised or guarantees granted by it" (emphasis added).

Under its Statute, the EIB's lending volume is capped by a statutory gearing ratio. It is permitted to have outstanding loans and guarantees of up to two and one-half times its subscribed capital, reserves, non-allocated provisions, and profit and loss account surplus. The latter aggregate amount must be reduced by an amount equal to the amount subscribed (whether or not paid in) for any equity participation of the EIB.[8] As of December 31, 2012, the EIB's total subscribed capital was EUR 242.4 billion (of which EUR 21.6 billion was paid-in) and reserves, non-allocated provisions and profit and loss account surplus totaled EUR 33.6 billion. As of December 31, 2012, EIB had a total balance sheet of EUR 508.1 billion. Outstanding loans and guarantees totaled EUR 495 billion equivalent.[9]

C. The EIB's Funding

The EIB raises capital for its financing operations primarily by issuing bonds on international capital markets. Bonds are issued in around 20 currencies, chief among them the Euro, US Dollar and British Pound, in order to diversify and optimize funding sources. As a Treaty entity and due to its backing by 27 sovereigns and its conservative financial management, the EIB enjoys a AAA credit rating, which allows it to obtain favorable credit terms.

D. Use of Swaps and Other Derivatives

The EIB uses derivative instruments principally for micro and macro-hedging purposes. It does not enter into any trading of derivatives.

The EIB uses derivative instruments, predominantly currency and interest rate swaps, as part of its asset and liability management ("ALM") activities to manage exposures to interest rate and foreign currency risks.

The majority of the EIB's swaps are entered into with a view to hedging specific bond issues. The EIB enters into interest rate swaps and currency swaps, whereby the proceeds of a borrowing are initially converted into a different currency and on maturity the EIB will obtain the amounts needed to service the borrowing in the original currency. The EIB also enters into currency, interest rate and overnight index swaps as part of its hedging operations on loans or for its global ALM position. Long-term, exchange-traded futures[10] are also used by the EIB to adjust the interest rate exposure of its treasury bond portfolios.

All of the EIB's long-term derivative transactions are conducted in the contractual framework of appropriate ISDA Master Swap Agreements with Credit Support Annexes (or their equivalent), which specify the conditions of exposure collateralization by the EIB's counterparties. Financial risk policy guidelines specify collateral management rules, and establish detailed eligibility criteria and risk limits for swap counterparties. Credit risk associated with derivatives is managed by selecting well-rated counterparties, and trading

8 Statute Article 16, Section 5.

9 In 2012, the Bank's lending totaled EUR 52.2 billion, of which EUR 44.7 billion was within the EU and EUR 7.5 billion was outside.

10 These are standardized derivatives traded on regulated markets and not swaps or other OTC derivatives.

with counterparties only under collateral agreements and within risk limits. Of the notional value of the EIB's derivatives portfolio, 72% was with counterparties rated internally as A-1 or higher in 2012. The EIB's year-end 2012 unsecured exposure in derivatives transactions (EUR 3.5bn) and potential unsecured exposure[11] (EUR 14.5bn) represent respectively only 1.3% and 5.3% of the EIB's subscribed capital and reserves (EUR 275bn).

The EIB is forbidden from seeking to generate profit from OTC derivatives transactions. As noted above, the Statute also prohibits the EIB from engaging in currency arbitrage.[12]

II. OTC derivatives with MDBs should be excluded from the capital requirement for CVA

As explained above, access to the swaps and derivatives markets is integral to the mission of the EIB and other MDBs. Therefore, the EIB respectfully requests that the Agencies adopt the proposals of the commenters noted above to exclude OTC derivatives with MDBs from the CVA capital requirements. Such an exclusion would be appropriate in light of the low credit risk of exposures to these entities and to ensure consistency in the treatment of MDBs within proposed and final capital rules in the United States, as well as within the EU's capital framework.

A. Low Credit Risk of Exposure / Consistent Treatment of MDBs

MDBs should receive consistent treatment among the Proposals and the Market Risk Final Rule. Exposures to MDBs receive a zero percent risk weighting under the Standardized Approach NPR. In the Standardized Approach NPR, the Agencies stated that assigning a zero percent risk weight to exposures to MDBs "is appropriate in light of the general high-credit quality of MDBs, their strong shareholder support, and a shareholder structure comprised of a significant proportion of sovereign entities with strong creditworthiness."[13] Based upon the same underlying rationale, the Market Risk Final Rule also permits a banking organization that uses a standardized method to calculate specific risk capital requirements to assign a zero specific risk-weighting factor to a debt position that is an exposure to an MDB.[14] Moreover, under both the current and proposed advanced approaches rules, exposures to sovereign entities, the Bank for International Settlements, the International Monetary Fund, the European Commission, the European Central Bank, and MDBs are exempt from the 0.03 percent probability of default floor.[15] We believe that the Agencies should exclude OTC derivatives transactions with MDBs from the capital requirement for CVA in light of the low credit risk of exposures to such

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11 Potential future exposure is measured at a 90% confidence level, over 10 to 20 business days.

12 Statute, Article 21.

13 Standardized Approach NPR at 52,896.

14 *See* Market Risk Final Rule § 10(b)(2)(ii).

15 *See* 12 C.F.R. Part 225, Appendix G, § 31(d)(2).

We believe that the Agencies should exclude OTC derivatives transactions with MDBs from the capital requirement for CVA in light of the low credit risk of exposures to such entities, and to ensure consistency in the capital treatment of MDBs in the proposed and final capital rules in the United States.

B. International Harmonization Efforts

International consistency in the capital treatment of MDBs is also of paramount importance to ensure uniform treatment of MDB counterparties and to avoid the opportunity for regulatory arbitrage. In the EU, the Capital Requirements Directive and Capital Requirements Regulation (collectively, "CRD IV") was adopted by the European Parliament on 16 April 2013. CRD IV exempts banks from the CVA market risk calculations for their derivative transactions with enumerated MDBs.[16] The Advanced Approach NPR does not contain a similar exclusion. If the CRD IV becomes final as proposed with respect to this exclusion, it will likely place U.S. banks at a material competitive disadvantage vis-à-vis their European counterparts, making it difficult for U.S. banks to compete effectively in the derivatives market. Therefore, we believe it would be in the best interests of U.S. institutions for the Agencies to make the Advanced Approach NPR consistent with the CRD IV by excluding OTC derivatives with MDBs from the CVA capital requirements.

III. Liquidity Coverage Ratio and High Quality Liquid Assets

We understand that the Agencies are currently developing regulations to implement Basel III's qualitative liquidity requirements for large global banks, including with respect to the liquidity coverage ratio ("LCR") contemplated by Basel III.[17] As with the CVA treatment of MDB counterparties, the treatment of MDB debt has a significant impact on the ability of MDBs such as EIB to carry out their missions. If bonds issued by EIB were not assigned a zero-percent risk weighting for LCR purposes, both the cost and availability of funding for EIB, and therefore its mission, would be severely and negatively impacted. For the reasons identified above—most notably, its status as a Treaty entity and its backing by 27 sovereigns—EIB, like other MDBs, has the low risk profile typically associated with its sovereign stakeholders. Accordingly, as the Agencies consider the question of what assets constitute "High Quality Liquid Assets" (HQLA) for purposes of the LCR, we encourage the Agencies to classify EIB bonds as HQLA Level 1 assets (i.e the lowest-risk category), in line with the treatment currently foreseen in Basel III and in CRD IV.

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[16] The proposed exclusions from the CVA requirements are set forth in Article 372 of the Capital Requirements Regulation. Paragraph 3a of Article 372 states, "The following transactions are excluded from the own funds requirement for CVA risk: ... d) Transactions between counterparties referred to in Article 1 paragraph 4 (a) and (b) and 5 (a) to (c) of Regulation (EU) No. 648/2012." Paragraph 5(a) of Article 1 includes enumerated MDBs, such as the EIB, the International Bank for Reconstruction and Development, the International Finance Corporation, the Inter-American Development Bank, and the European Investment Fund, among others.

[17] *See* Testimony of Governor Daniel K. Tarullo Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C. (Feb. 14, 2013), *available at* http://www.federalreserve.gov/newsevents/testimony/tarullo20130214a.htm.

IV. Conclusion

The EIB respectfully submits that the Agencies should create an exclusion for MDB counterparties from the CVA requirements of the Advanced Approaches NPR, as supported by comment letters previously submitted by the American Bankers Association, the Securities Industry and Financial Markets Association, and the Financial Services Roundtable; The Clearing House and the American Securitization Forum; the World Bank; and JPMorgan Chase & Co. As set forth in those letters and discussed herein, such an exclusion would be appropriate in light of the low credit risk of exposure to such entities and would ensure consistency in the treatment of MDBs both within the proposed and final capital rules in the United States and within the EU's capital framework. Similarly, as you formulate your approach to the question of Basel III's LCR requirement, we encourage you to acknowledge the minimal default risk of MDB-issued debt by classifying it as an HQLA Level 1 asset, as discussed above.

We thank you for this opportunity to comment. If you have any questions about the EIB or the impact of the proposed rules on its core mission, please communicate with Whitney Debevoise of Arnold & Porter LLP at 202 942 5042 or Whitney.Debevoise@aporter.com.

Respectfully submitted,

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