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Via ESMA Web Site

Response to the ESMA Discussion Paper "Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories"

Dear Sirs,

We would like to thank you very much for granting us the opportunity to submit this letter in response to the above mentioned ESMA Discussion Paper ("DP") issued on February 16, 2012. We would be grateful if the following comments would be taken into due consideration.

1. Background on KfW

KfW was established in 1948 by the Administration of the Combined Economic Area, the immediate predecessor of the Federal Republic. KfW is a German public law institution (*Anstalt des öffentlichen Rechts*) organized under the Law Concerning KfW (*Gesetz über die Kreditanstalt für Wiederaufbau*, or KfW Law). The Federal Republic holds 80% of KfW's equity capital and the German federal states hold the remaining 20%.

As a German state-owned promotional bank, KfW serves domestic and international public policy objectives of the German Federal government, primarily by engaging in various promotional lending activities. KfW's lending activities include domestic financing, primarily made through commercial banks, including, in particular, loans to small and medium-sized enterprises and housing-related loans, export and project finance through KfW's wholly-owned subsidiary KfW IPEX-Bank GmbH and development finance for developing and transition countries. KfW is a public sector entity as defined in Article 4 (18) of Directive 2006/48/EC.

The KfW Law expressly provides that the Federal Republic guarantees all existing and future obligations of KfW in respect of money borrowed, bonds and notes issued and derivative transactions entered into by KfW (KfW Law, Article 1a). Under this statutory guarantee, if KfW fails to make any payment of principal or interest or any other amount required to be paid with respect to any of KfW's obligations mentioned above, the Federal Republic will be liable at all times for that payment as and when it becomes due and payable. The Federal Republic's

obligation under the Guarantee of the Federal Republic ranks equally, without any preference, with all of its other present and future unsecured and unsubordinated indebtedness.

2. Comments on the Discussion Paper

a) Q12

Q12: "What are your views regarding the timing for the confirmation and the differentiating criteria? Is a transaction that is electronically executed, electronically processed or electronically confirmed generally able to be confirmed more quickly than one that is not?"

In relation to question number 12 as set out above, we note the following:

Sections 37 to 41 of the DP deal with the "Timely confirmation" of derivative transactions, which is one of the risk mitigation techniques prescribed by EMIR for non-CCP cleared derivative transactions. According to section 38 of the DP, financial counterparties and non-financial counterparties exceeding the clearing threshold should confirm the terms of any OTC derivative transaction as described in more detail therein. According to section 39 of the DP, counterparties "other than those indicated above" (i.e. financial counterparties and non-financial counterparties exceeding the clearing threshold) should confirm the terms of any OTC derivative within time limits which are less tight than those outlined in section 38.

We are concerned that the reference to counterparties "other than those indicated above" in section 39 of the DP might be misinterpreted by market participants to include those entities to which EMIR shall not apply in accordance with Article 1 of EMIR.

It is our general understanding of the purpose of the non-applicability clauses of Article 1 of EMIR that transactions with entities to which EMIR does not apply will not be subject to any of the obligations set out by EMIR unless explicitly stated to the contrary therein (e.g. the reporting obligation in respect of some of those entities). Given the bilateral nature of derivative transactions, this necessarily implies that any financial counterparty or non-financial counterparty generally subject to EMIR which concludes derivative transactions with such entities will not be subject to the requirements of EMIR in respect of these particular transactions either. If this were not the case, the non-applicability clauses of EMIR would be without substance. This general understanding should apply to both Article 3 of EMIR "Clearing obligation" and Article 6 / 8 of EMIR "Risk mitigation techniques for OTC derivative contracts not cleared by a CCP", including but not limited to the requirement of a timely confirmation of derivative transactions which is the subject of sections 37 to 41 of the DP.

In this context, we note that the ESA Joint Discussion Paper on Draft Regulatory Technical Standards on risk mitigation techniques for OTC derivatives not cleared by a CCP under the Regulation on OTC derivatives, CCPs and Trade Repositories (JC/DP/2012/1) dated 6 March 2012 clarifies in Section 15, for avoidance of doubt, that non-financial counterparties which are not above the clearing threshold are not required by EMIR to hold adequate capital or collateral and therefore will not be required to exchange either variation margin or initial margin, *irrespective of their counterparties*. The wording clarifies that the obligation to "exchange" collateral - which generally is applicable to financial counterparties and non-financial counterparties that exceed the clearing threshold - is not imposed on such counterparties if their counterparties are not subject to this obligation, which we interpret as confirmation of our general understanding of the purpose of the non-applicability clauses of Article 1 of EMIR as described in the preceding paragraph.

Based on this understanding and to prevent potential misinterpretations, we kindly ask ESMA to clarify in the Regulatory Technical Standards ("RTS") that the requirement to use the risk mitigation techniques prescribed by Article 6 / 8 of EMIR shall not apply to any counterparty in respect of derivative transactions concluded with entities to which EMIR does not apply according to Article 1.

b) Annex II "Trade Repositories table of fields"

In the context of what has been outlined above, we would like to make the following observations and suggestions with respect to the table of fields developed by ESMA in relation to the reporting obligations under Article 6 / 8 of EMIR.

aa) In Annex II Table 1 – Counterparty Data – the categorization in the seventh line of the table refers to "*F = Financial Counterparty / N = Non-Financial Counterparty*".

In our view, the above mentioned categorization is not relevant in respect of entities to which EMIR does not apply. There is thus no need to differentiate between the status of a financial or non-financial counterparty for these entities, as they constitute a class *sui generis*.

We therefore recommend to introduce a third category besides "Financial Counterparties" and "Non-Financial Counterparties" such as "Ex = exempt in accordance with Article 1 of EMIR". This additional category might also provide useful information for ESMA and the competent authorities when analyzing the reporting data.

bb) Further, in Annex II Table 1 – Counterparty Data – it needs to be indicated whether the contract is above the clearing threshold or not ("*Y = above / N = below*").

cc) Finally, in Annex II Table 2 – Common Data Section 2 c) – a reference is made to "*Collateralization Y = Yes / N = No.*"

In our opinion, neither the clearing threshold as mentioned in bb) nor the collateralization as mentioned in cc) are relevant in respect of entities to which EMIR does not apply. We therefore recommend to introduce a third category besides "Yes" or "No" such as "N/A = Not Applicable" to help reporting entities to correctly categorize their transactions with entities not being subject to EMIR.

If the items mentioned under aa) to cc) in the form as proposed by ESMA were interpreted together, ESMA might actually draw wrong conclusions, in particular, that the clearing obligation or the obligation to exchange collateral may not have been fulfilled, while such obligation is actually not applicable due to the fact that one of the counterparties is an entity to which EMIR does not apply.

c) Q44 – Collateral requirements (Article 43)

Q44: "Do you consider that financial instruments which are highly liquid have been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of cash of financial instruments? Do you consider that the bank guarantees or gold which is highly liquid has been rightly identified? Should ESMA consider other elements in defining liquid collateral in respect of bank guarantees or gold?"

We fully agree with ESMA's criteria based approach and also see the risk that a prescriptive approach would have the drawback of being inflexible and difficult to define.

We note that ESMA is required to define the type of collateral that can be considered highly liquid and is envisaging to take into account criteria such as transferability, credit and market risk, the existence of a liquid and diversified market and the absence of procyclicality or wrong way risk.

The criteria based approach as set out in section 120 of the DP envisages a list of factors to be met for purposes of determining whether assets would be deemed highly liquid. These factors include whether the asset has been issued by an issuer with low credit risk, has a low market risk, is freely transferable, has a diverse group of buyers and sellers, and has price data published on a regular basis. Furthermore, the assets shall not have been issued by the clearing member, or the parent or subsidiary of the clearing member.

With respect to the last factor, we agree that it is a basic principle that the credit quality of the obligor and collateral posted by such obligor shall not have a material positive correlation. This general principle also applies for the collateralization of repo transactions with the European System of Central Banks, i.e. the central bank's counterparty may not post assets issued by itself as collateral for the repo transaction. However, for such repo transactions an exemption applies if the asset is guaranteed by a public authority of an EEA country which has the right to levy taxes¹.

From our point of view, there is no reason why the requirements regarding the collateral acceptable for CCP's should be more demanding than the sophisticated standards of the European Central Bank for central bank lending. Thus, we are of the opinion that assets issued by entities carrying an explicit guarantee provided by a central government should be considered highly liquid and be excluded from the general prohibition that the clearing member may not post assets issued by itself or its parent or subsidiary.

Therefore, when looking at the above mentioned criteria determining highly liquid assets, we are of the opinion that the criteria are too narrow and thus financial instruments which are highly liquid have not yet fully been identified by ESMA.

Furthermore, the proposed exclusion of the general prohibition for clearing members to post assets issued by themselves as collateral would be consistent with the requirements set out in "Investment policy (Article 44)" section 135 number 1 for eligible investment assets which reads that (vii) financial instruments which have been issued or are explicitly guaranteed by a government of a country that the CCP can demonstrate with a high degree of confidence that it has a low credit risk" are viewed as being eligible as investment and therefore deemed to be safe. Therefore, such issues should also be eligible collateral for the purpose of Article 43.

¹ Section 6.2.3 of Guideline ECB/2000/7 of the European Central Bank on the implementation of monetary policy in the euro area.

In conclusion, we kindly suggest to include in the RTS an exclusion from the requirement outlined in section 120 of this DP that clearing members may not post assets issued by themselves or by their parent or subsidiary for assets that carry an explicit guarantee provided by a central government.

Sincerely,

KfW



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Treasurer