NBIM
Norges Bank Investment Management

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

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Office of the Comptroller of the Currency
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Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, DC 20551

RE: Margin and Capital Requirements for Covered Swap Entities; OCC Docket ID OCC-2011-0008; Federal Reserve Docket No. R-1415, RIN number 7100 AD74; FDIC RIN number 3064-AD79; FHFA RIN 2590-AA45;

Ladies and Gentlemen:

Norges Bank Investment Management welcomes the opportunity to comment on the rules (the "Margin Rules") recently proposed by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency (the "Agencies") regarding margin and capital requirements for covered swap entities, implementing requirements of Title VII of the Dodd-Frank Wall Street Reform and

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Consumer Protection Act (the "Dodd-Frank Act"). Norges Bank Investment Management ("NBIM") is a division of Norges Bank, the central bank of the Kingdom of Norway. [1]

In general, the Margin Rules would require covered swap entities (swap entities that are prudentially regulated by the Agencies) to collect initial and variation margin from their swap counterparties in connection with uncleared swaps. Those margin amounts are required to be calculated in a manner described in the Margin Rules. The Margin Rules distinguish between counterparties who are "financial end users" and those who are not.

For a nonfinancial end user, a covered swap entity may establish initial and variation margin thresholds taking into account the credit risk posed by that nonfinancial end user counterparty. A covered swap entity also has the flexibility to collect variation margin from a nonfinancial end user as infrequently as weekly (rather than daily, as for financial end users). Covered swap entities have no such flexibility in their dealings with financial end users. By making "any government of any foreign country or a political subdivision, agency, or instrumentality thereof" a financial end user, the Margin Rules would impose on any such entity margin requirements applicable to ordinary commercial investors, and would preclude the ability of the parties to tailor margin requirements – through margin threshold amounts and the timing of variation margin payments -- to the government entity in question and to any risks of nonperformance it might pose.

We respectfully submit that this approach does not recognize the important differences between sovereign and other governmental entities, on the one hand, and private investors, on the other, and is generally inconsistent with the Congress's approach to the extra-territorial application of the Dodd-Frank Act.

Background. In their release proposing the Margin Rules (the "Proposing Release")[2], the Agencies noted that the proposed definition of the term "financial end user" is "based upon, and substantially similar to, the definition of a 'financial entity' that is ineligible to use the end user exemption from the mandatory clearing requirements . . . of the Dodd-Frank Act." Importantly, however, the Agencies propose to add to the list "any government of any foreign country or any political subdivision, agency, or instrumentality thereof." In the Proposing Release, the Agencies wrote:

> "The Agencies note that these types of sovereign counterparties do not fit easily into the proposed rule's categories of financial and nonfinancial end users. In comparing the characteristics of sovereign counterparties with those of financial and nonfinancial end users, the Agencies preliminarily believe that the financial condition of a sovereign will tend to be closely linked with the financial condition of its domestic banking system, through common effects of the business cycle on both

[1] We are today submitting similar comments to the Commodity Futures Trading Commission, in respect of the rules proposed by it in *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 23732 (April 28, 2011).
[2] *Margin and Capital Requirements for Covered Swap Entities*, 76 Fed. Reg. 27564 (May 11, 2011).

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government finances and bank losses, as well as through the safety net that many sovereigns provide to banks. Such a tight link with the health of its domestic banking system, and by extension with the broader global financial system, makes a sovereign counterparty similar to a financial end user both in the nature of the systemic risk and the risk to the safety and soundness of the covered swap entity."

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

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

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

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

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

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"person" the term should not generally be regarded as including a sovereign entity absent an evident contrary Congressional purpose.[4]

Last, classification of foreign sovereigns and their agencies and instrumentalities as financial end users leads to unreasonable and, we expect, unintended results under the Margin Rules themselves. For example, the Margin Rules distinguish between "high-risk" and "low-risk" financial end users for purposes of, among other things, determining whether they qualify for initial and variation margin thresholds. Qualification as a low-risk financial end user depends on whether a financial end user meets enumerated criteria, presumably reflecting a view that financial entities meeting those criteria present a lower level of risk than other financial entities. However, most, if not all, of the criteria a financial entity must meet to qualify as a "low-risk" financial end user are manifestly inappropriate for purposes of determining the risk posed by any foreign sovereign entity. For example, the requirement that the entity be "subject to capital requirements established by a prudential regulator or state insurance regulator" would, of course, virtually never be met by a foreign sovereign or its agencies or instrumentalities. In addition, the criteria place limits on the nature and amount of swap activity in which the entity may engage consistent with low-risk status – limits that are inappropriate in the case of foreign sovereigns and their agencies and instrumentalities, which enter into transactions for a wide variety of governmental purposes, such as in connection with the control of their foreign currencies. The effect of these provisions is to classify *all* foreign sovereigns and their agencies and instrumentalities, regardless of their individual credit standings, as high risk financial end users together with financial entities whose risk profiles do not permit them to benefit from collateral thresholds (among other things) -- reflecting a presumption that is, in our view, inappropriate and not in line with the risks posed by many, if not most, such entities.

In light of the large number and different types of foreign governmental entities who in the normal course of their activities from time to time might transact in the swap markets, we do not believe that a separate classification for sovereign counterparties is necessary or appropriate under the Margin Rules. Rather, we respectfully urge that the Agencies remove foreign governments, central banks, and foreign governmental subdivisions, agencies, and instrumentalities from the definition of "financial end user" and allow such entities to agree with their covered swap entity counterparties the amounts of their initial and variation margin thresholds and the timing of variation margin deliveries.

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

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

Yours sincerely,

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