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August 21, 2013

By Electronic Filing

Elizabeth M. Murphy, Secretary,
Securities and Exchange Commission,
100 F Street NE.,
Washington, DC 20549-1090.

Re: Release No. 34-69490
File Numbers S7-02-13, S7-34-10 and S7-40-11

Dear Mrs. Murphy:

We are submitting these comments as a supplement to those of the International Bank for Reconstruction and Development (generally known as the "World Bank") and the International Finance Corporation ("IFC") in response to the Securities and Exchange Commission's ("SEC") request for comments on its proposed rules and interpretive guidance to address the application of the provisions of the Securities Exchange Act of 1934 ("Exchange Act") that were added by Subtitle B of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "DFA") to cross-border security-based swap activities, as set forth in the above release (the "Release"). These comments, like the World Bank and IFC's comments, apply to the other multilateral development institutions in which the United States is a member and which are listed on Schedule A hereto (collectively with the World Bank and IFC, the "MDBs"), and are being submitted (a) to reiterate their and our concern that the SEC, in its proposals of regulations under DFA, has not fully addressed the potential breach of the MDBs' privileges and immunities posed by certain of those proposed regulations and (b) to explain that their affiliates are also covered by those privileges and immunities, as well as to respond to the request set forth in footnote 301 of the Release for comments with respect to affiliates of the international organizations specifically excluded from the definition of "U.S. person" in the proposed rules.

I. BACKGROUND

At the request of the World Bank and IFC, we rendered an opinion to them, dated October 5, 2011 (the "Opinion"), to the effect that the application to the

World Bank and IFC and the derivatives transactions to which they are a party ("swaps") of the regulations proposed or adopted by the Commodity Futures Trading Commission ("CFTC") 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 World Bank and IFC by their respective Articles of Agreement (the "Articles") and implemented as U.S. domestic law by the Bretton Woods Agreements Act in 1945 (22 U.S.C. § 286 (2006)) and the International Finance Corporation Act in 1955 (22 U.S.C. § 282 (2006)) (the "Implementing Legislation"), thus constituting a breach by the United States of its international law obligations contained in the Articles and a violation of the domestic law of the United States established by the Implementing Legislation. Because we understood that the World Bank and IFC did not engage in "security-based swaps", our opinion only addressed regulation by the CFTC, but we added that were the World Bank or IFC to engage in "security-based swaps", our conclusions would also apply to the counterpart "security-based swaps" regulations of the SEC. The Opinion did not address the application of the anti-fraud provisions of any laws or regulations administered by the CFTC or the SEC.

By letter dated October 5, 2011, the World Bank submitted the Opinion to the CFTC and SEC on behalf of itself, IFC and the other MBDs.[1] Although the Opinion was addressed to the World Bank and IFC, it would apply equally to the other MDBs, which have substantially identical privileges and immunities in their respective Articles of Agreement (or equivalent) that have been similarly enacted into domestic U.S. law by legislation similar to the Implementing Legislation.[2]

In Release No. 34-66868 (File No. S7-39-10), 77 Fed. Reg. 30596 (May 23, 2012) (the "Definitions Release"), the CFTC and the SEC adopted new rules and interpretive guidance under the Commodity Exchange Act ("CEA") and the Exchange Act to further define the terms "swap dealer" ("SD"), "security-based swap dealer" ("SBSD"), "major swap participant" ("MSP") and "major security-based swap participant" ("MSBSP"). In the Definitions Release, the CFTC stated that it did not believe that foreign governments, foreign central banks and international financial institutions (defined by the CFTC to include the MDBs) should be required to register as SDs or MSPs.[3] In reaching its decision, the CFTC noted that "foreign entities are not

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1 The Opinion and the World Bank cover letter can be found in the CFTC file of comments on the joint CFTC-SEC release entitled "Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant' and 'Eligible Contract Participant'," 75 FR 80174, at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48505.

2 A list of the MDBs, together with the Articles of their Articles of Agreement containing their privileges and immunities and the citation for their Implementing Legislation, is set forth in Schedule A hereto.

3 Definitions Release in text accompanying footnotes 1177-1185. Footnote 1181 indicated that the SEC would address issues related to the application of the MSBSP

necessarily immune from U.S. jurisdiction for commercial activities undertaken with U.S. counterparties or in U.S. markets", citing the Foreign Sovereign Immunities Act, 28 U.S.C. 1602 ("FSIA"), exemption of commercial transactions from sovereign immunity, and therefore, "a per se exclusion for foreign entities from the CEA's [MSP] or [SD] definition . . . is inappropriate." On the other hand, the CFTC pointed out that the "sovereign or international status" of, among others, foreign financial institutions (such as the MDBs) "is relevant in determining whether such entities are subject to registration and regulation as" an MSP or an SD and noted that "[t]here 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 . . . requiring" that, among others, foreign financial institutions (such as the MDBs) register as SDs or MSPs "and be regulated as such". The Definitions Release cited the Supreme Court's reliance in *F. Hoffman-LaRoche, Ltd.* v. *Empagran S.A.*, 542 U.S. 155, 164 (2004), on the "Charming Betsy" canon from *Murray* v. *Schooner Charming Betsy*, 2 Cranch 64, 118, 2 L.Ed. 208 (1804) ("[A]n act of congress ought never to be construed to violate the law of nations if any other possible construction remains"), also cited by us in the Opinion.

After reviewing a draft of the Definitions Release prior to its publication in the Federal Register, by a letter dated May 17, 2012 (a copy of which is attached for background), the General Counsels of the World Bank and IFC, with our strong concurrence, wrote to the CFTC and the SEC, pointing out the analytical errors in the explanation of the CFTC's no-registration conclusion, insofar as that conclusion applied to the MDBs. The errors pointed out by the General Counsels were that:

1. The statement in the text accompanying footnote 1182 in the Definitions Release with respect to foreign entities not necessarily being immune from U.S. jurisdiction for commercial activities did not apply to the MDBs, because the immunity of the MDBs is not derived from the FSIA but is specifically provided for in their respective Articles of Agreement, and thus differs from the sovereign immunity provided for in the FSIA in the following important ways:

   a. The MDBs' Articles of Agreement are international agreements binding on the United States and have been enacted into U.S. domestic law.

   b. The MDBs' Articles of Agreement not only provide immunity from suits by their Member states[4] (and persons acting on their behalf), they also provide immunity from Member state regulation.

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definition to non-U.S. entities as part of a separate release on the application of Title VII to non-U.S. persons.

[4] The Members of each MDB are the sovereign states, including the United States, that are parties to their Articles of Agreement, an international agreement. They are referred to herein as "Members".

c. The immunities of the MDBs are not affected by whether they engage in commercial activities (which they do engage in).

2. The summary of holdings in the three cases cited in footnote 1182 of the Definitions Release was not correct and those cases did not support the conclusion in the text accompanying footnote 1182 with respect to foreign entities not necessarily being immune from U.S. jurisdiction for commercial activities, 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.[5]

In its subsequent rule-making entitled "End-User Exception to the Clearing Requirement for Swaps" (77 Fed. Reg. 42,560 (July 19, 2012)) (the "Clearing Release"), the CFTC reached the same conclusion as it did in the Definitions Release and concluded that international financial institutions (including the MDBs) should not be subject to the clearing requirement set forth in Section 2(h)(l) of the CEA. In doing so, the CFTC specifically acknowledged that "international financial institutions operate with the benefit of certain privileges and immunities under U.S. law", and are thus entitled to the benefit of the same canons of statutory interpretation applicable to "the legitimate sovereign interests of other nations". In reaching its conclusion not to subject the international financial institutions to the clearing requirements of the CEA, the CFTC again relied on the "Charming Betsy" canon.

The CFTC did not, however, exclude the international financial institutions from compliance with the Regulations and the CEA in transactions with counterparties that are themselves subject to the CFTC's regulations and the CEA, citing in particular the recordkeeping and reporting requirements. The CFTC did not discuss the fact that counterparties that are themselves subject to the CFTC's regulations and the CEA would be obligated to require the international financial institutions to post collateral to secure their obligations (the "margin requirement").

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[5] The three cases cited in footnote 1182 and their holdings are: *Mendaro* v. *World Bank*, 717 F.2d 610 (DC Cir. 1983)(the World Bank's "articles waive [its] immunity from actions arising out of [its] *external* relations with its debtors and creditors", but "a waiver of immunity to suits arising out of [its] *internal* operations, such as its relationship with its own employees, would contravene the express language of" its Articles of Agreement (emphasis in original)); *Osseiron* v. *International Financial Corp.*, 552 F.3d 836 (DC Cir. 2009) (following *Mendaro*, no immunity from suits based on "commercial transactions with the outside world", because such immunity "can hinder an organization's ability to operate in the marketplace"); and *Vila* v. *Inter-American Investment Corp.*, 570 F.3d 274 (DC Cir. 2009) (following *Mendaro* and *Osseiron*, no immunity from suit by independent consultant for unjust enrichment).

In a letter dated September 14, 2012 commenting on the CFTC's proposed regulations entitled "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants" (76 Fed. Reg. 23732 (April 28, 2011)) (the "CFTC Margin Release Comment Letter"), the General Counsels of the World Bank and IFC objected to requiring the MDBs to post margin, pointing out (in reliance on the Opinion) that "[r]egulation 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" of the MDBs.[6] The provisions of the Opinion relied on by the General Counsels are set forth below under "Summary of the Opinion".[7]

The CFTC Margin Release Comment Letter went on to point out that:

1. Subjecting the MDBs to the margin requirements would be inconsistent with the CFTC's statutory mandate "to adopt capital and margin requirements that (1) Help ensure the safety and soundness of the [SD or MSP] registrant; and (2) are appropriate for the risk associated with the uncleared swaps" held by SDs[8] and MSPs and would serve no policy purpose, given the MDBs' credit-worthiness and the fact that they use swaps only for risk management purposes and not for speculation, citing "a clear consensus among credit rating agencies, capital markets participants, and regulatory capital standard setters that exposures to MDBs pose no serious risks".

2. Imposing margin requirements on MDBs would impair the development effectiveness of MDBs, by increasing costs, limiting lending and investment operations, diverting the use of scarce capital, and potentially affecting concessional aid to the poorest of the poor.

3. Imposing margin requirements on MDBs would create international comity concerns, citing the concern expressed by the CFTC in the Clearing Release.[9]

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6 The CFTC Margin Release Comment Letter is on file with the CFTC at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58958.

7 In the CFTC Margin Release Comment Letter, the General Counsels noted in footnote 5 that the MDBs "have no objection to reporting by our commercial counterparties of swap transactions with our institutions". (Emphasis added.) The reference to "commercial counterparties" was to counterparties which are themselves subject to the CFTC's regulations and the CEA.

8 See 76 Fed. Reg. at 23733 (capitalization in original).

9 The CFTC Margin Release Comment Letter pointed out that comity is not generally an issue in the case of the MDBs, because all MDB Members are similarly obligated as a matter of international law to respect the privileges and immunities of the MDBs.

The CFTC Margin Release Comment Letter also urged the CFTC to exclude the MDBs (and related entities, such as the World Bank's employee benefit plans) from the definition of "financial entity", rather than having to address every issue, such as reporting, that will otherwise arise, and to exclude the MDBs from the definition of "U.S. person" for all purposes of Title VII, in order to avoid the inadvertent regulation of transactions where the counterparty is a non-regulated, non-U.S. person (see the further discussion of this issue in Paragraph III.4 below under "Comments on the Proposed Rule").

On February 22, 2013, the General Counsel of the World Bank and the Acting General Counsel of IFC submitted a letter to the SEC commenting on its release entitled "Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker Dealers" (77 Fed. Reg. 70,214) (November 23, 2012) (the "SEC Margin Release Comment Letter").[10] The SEC Margin Release Comment Letter was substantively the same as the CFTC Margin Release Comment Letter, adding the following:

- Subjecting the MDBs to the SEC's margin requirements, as in the case of the CFTC's counterpart rules, would be inconsistent with what the SEC has described as its statutory mandate and articulated as the policy goals of the proposed rules (to "help ensure the safety and soundness" of the SBSDs and the MSBSPs and "be

[10] The SEC Margin Release Comment Letter is on file with the SEC at http://www.sec.gov/comments/s7-08-12/s70812.shtml#comments. The World Bank and IFC also filed a comment with the Bank for International Settlements' Basel Committee on Banking Supervision ("BCBS") and the Board of the International Organization of Securities Commissions' ("IOSCO") Working Group on Margining Requirements on the Consultative Document on Margin Requirements for Non-Centrally Cleared Derivatives on September 28, 2012 (the letter can be found at http://www.bis.org/publ/bcbs226/comments.htm). In February 2013, BCBS and IOSCO issued a "near-final policy framework that establishes minimum standards for margin requirements for non-centrally cleared derivatives", which supported excluding the MDBs from the requirements to collect or post margin. Members of the Working Group on Margining Requirements include Thomas McGowan of the SEC, John Lawton of the CFTC, Sean Campbell of the Board of Governors of the Federal Reserve System, Mari Baca of the Federal Reserve Bank of New York, Bobby Bean of the Federal Deposit Insurance Corporation, Kurt Wilhelm of the Office of the Comptroller of the Currency, and is co-chaired by Michael Gibson of the Board of Governors of the Federal Reserve System. On November 26, 2012, the World Bank and IFC filed a comment letter with 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 Agency (collectively, the "Prudential Regulators") regarding their proposed rule entitled "Margin and Capital Requirements for Covered Swap Entities" (the letter can be found at http://www.federalreserve.gov/apps/foia/ViewAllComments).

appropriate for the risk associated with non-cleared security-based swaps held" by an SBSD or MSBSP).

- Evidence supporting the MDBs' position can be found in the determinations of several of the "prudential regulators" identified in the SEC Margin Release Comment Letter in implementing capital requirements for transactions between MDBs and entities subject to their prudential regulation.
- Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade Repositories (also known as "EMIR") has addressed the issue of margin requirements on non-cleared swaps from a European perspective. EMIR exempts, among others, the MDBs.

II. SUMMARY OF THE OPINION

The Opinion concluded that the application of the Regulations to the World Bank and IFC (which we refer to in the Opinion and this Summary as the "Organizations") and the swaps transactions to which they are a party would violate the privileges and immunities provided to the Organizations by their respective Articles and implemented as U.S. domestic law by the Implementing Legislation, thus constituting a breach by the United States of its international law obligations contained in the Articles and a violation of the domestic law of the United States established by the Implementing Legislation.

Following is a summary of how the Opinion reached its conclusions:

1. The Basis of the Organizations' Privileges and Immunities

a) *The Articles of Agreement and the Implementing Legislation.* Article VII of the World Bank 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 World Bank 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 World Bank Article VII and IFC Article VI). The United

States executed these obligations by passing the Implementing Legislation, which expressly provides that the privileges and immunities set forth in 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 Opinion also described the International Organizations Immunity Act, 22 U.S.C. §288a ("IOIA"), which 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.[11]

While the primary source of the Organizations' privileges and immunities are their Articles of Agreement and the related Implementing Legislation, the IOIA does supplement and reinforce certain of the privileges and immunities accorded to the Organizations under their Articles of Agreement and the Implementing Legislation,[12] and interpretations of the IOIA are instructive in understanding the privileges and immunities accorded by the Articles of Agreement. The Opinion notes another important difference between the Articles/Implementing Legislation and the IOIA immunities is that the latter may be denied by Presidential action, but the President does not have similar authority under the Articles of Agreement and the Implementing Legislation.[13]

c) *Purposes of the Privileges and Immunities*

The Opinion then outlined the premises on which the Organizations' immunities – and indeed, the Articles of Agreement as a whole – are based: (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

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[11] 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)).

[12] One instance where the IOIA grant of immunity is, on its face, broader than the Articles' grant of immunity is IOIA's immunity from judicial process. The *Mendaro* case referred to in footnote 5 and in Paragraph II.1(c) below, however, held that the World Bank's Articles waive immunity from "actions arising out of [its] external relations with its debtors and creditors". 717 F.2d at 618. (Emphasis in original.)

[13] This is one of the more significant differences between the immunities provided by the IOIA and immunities provided by the MDBs' Articles. The IOIA immunities may be denied by the President, but because the Articles have been implemented into U.S. domestic law, the Articles' immunities may be denied or limited only by an Act of Congress.

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 Opinion cited several occasions on which the United States has confirmed that the Organizations are not subject to U.S. financial regulations, such as the securities of the Organizations not being subject to the provisions of the Securities Act of 1933 ("Securities Act") and the Exchange Act. The Opinion also noted examples where the European Commission and other European governmental bodies have similarly exempted the Organizations from their regulations.

The Opinion noted that although there are relatively few court decisions interpreting the scope of the privileges and immunities of international organizations, and no case had been found that is directly on point with the facts and circumstances under consideration, the privileges and immunities of international organizations have been considered by courts and the executive branch in other regulatory contexts. The Opinion reviewed these authorities, including *Mendaro* v. *World Bank* (see footnote 5), which, as indicated above in the text accompanying footnote 5, was incorrectly summarized by the CFTC and the SEC in the Definitions Release. Perhaps the best summary of what these authorities hold is found in *Broadbent* v. *OAS*, 628 F.2d 27 (D.C. Cir. 1976), where the court, in finding immunity from suit on an employment contract, 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.)

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

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. Given the relevant canons of statutory interpretation and 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.

The Opinion relied on two long-recognized canons of statutory interpretation in reaching this conclusion: *generalia specialibus non derogant* ("the general do not derogate from the specific") and the "Charming Betsy canon".[14]

3. The Organizations' Purposes and Uses of Derivatives

Perhaps the most important underlying factors on which the Opinion is based are the Organizations' purposes and the purposes and manners in which they use 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 World Bank 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. IFC, for example, invests in equity in private sector enterprises and mobilizes capital from the private sector in order to supplement its direct investments.

The Organizations informed us that they 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 manage the risks to which they are exposed as a result of their activities. 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

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[14] As indicated above, the Charming Betsy canon was similarly relied on in the Definitions Release in the text accompanying footnote 1185 in reaching the conclusion that "[t]here 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 terms 'swap dealer' or 'major swap participant'".

international banks and swap dealers. These risk management transactions are part of a comprehensive suite of development financing tools that, in the Organizations' 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, the Organizations advised us that, in their 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, the Organizations advised that they 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. Notably, both Organizations currently require even highly rated major market counterparties to collateralize trades undertaken with the Organizations. They 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 consistently assigned low risk weightings to transactions with the Organizations under the Basel framework.[15]

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, the Opinion pointed out that 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 their view, neither management nor staff of the Organizations has any individual or collective financial incentive to undertake undue risk.

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[15] For greater detail, see the text accompanying footnotes 16-18 in the SEC Margin Release Comment Letter.

4. Application of the Regulations to the Organizations' Derivatives Would Violate Their Privileges and Immunities

To explain how and why the Opinion reached its conclusions, it first summarized the regulatory scheme embodied in the Regulations and then addressed how the major factors in that scheme would violate the Organizations' privileges and immunities. Although a number of those concerns have been addressed by the CFTC in the Definitions Release, its Clearing Release and, to a limited extent, in its final Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (the "Final Interpretive Guidance"), we nevertheless summarize this portion of the Opinion in order to provide a clear understanding of the breadth of the privileges and immunities and the regulatory measures that violate them.

a) *The Regulatory Scheme of the Regulations*. The Opinion pointed out that there were 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 – "direct regulations" and "direct regulation equivalents":

i. 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 "MSPs".[16] As an MSP, each would likely be required to, among other things:

   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;

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[16] Given the status of the Regulations as of the date of the Opinion, particularly the definition of SD and our inability to conclude that the Organizations' activities would cause them to come within the definition of SD, the Opinion did not address the effect of their being required to register as SDs, but we noted that the measures that would be applicable would create substantially the same conflicts with the Organizations' privileges and immunities as those that would be imposed on them as MSPs.

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.

ii. <u>Regulation of Derivatives Entered into by the Organizations with Regulated Entities ("Direct Regulation Equivalent")</u>. Even if the Organizations were not required to register as MSPs, transactions with entities that were MSPs or SDs would nevertheless subject the Organizations to several of the Direct Regulation measures. The example cited by the Opinion that is the most troublesome is the requirement that the Organizations post collateral as security for their swap obligations. This is the substantive equivalent of the Organizations' being subjected to Direct Regulation.

b) *Why the Regulations Would Violate the Organizations' Privileges and Immunities*. The Opinion then addressed the specific regulatory measures that would be applied to the Organizations, given the status of the Regulations as of the date of the Opinion, and set forth the following reasons they would violate specific aspects of their privileges and immunities:[17]

i. 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.

ii. 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. Being required to post

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[17] Our conclusions set forth in the Opinion as to the scope of the privileges and immunities of the Organizations in the context of the Regulations were, and in this letter 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. of the Opinion. In light of the scarcity of authority, and the absence of controlling authority in this specific context, the Opinion noted that the scope of the privileges and immunities of the Organizations in this context is not entirely free from doubt. Nevertheless, as stated in the Opinion, we believe that a court, if presented with a properly pleaded and argued case, should agree with our conclusions in the Opinion and herein as to their scope.

collateral in order to enter into a transaction, particularly when there is no indication that the collateral will ever be used, 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.

iii. 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. According to the Organizations, 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. Alternative measures to avoid regulation, such as removing themselves from the larger marketplace and transacting wholly with other non-regulated entities or limiting their activities to jurisdictions where their activities are not regulated, limiting lending activities and discontinuing the provision of risk management tools to borrowing countries and other clients, would impede the development effectiveness of the Organizations.

5. Regulation of the Organizations or Their Swaps Is Not Necessary

The Opinion pointed out that 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.

The Opinion pointed out that, of course, 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 the Organizations 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.

6. Conclusion

The Opinion concluded that Direct Regulation and 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 noted the Organizations' concern that inclusion of them 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.

III. COMMENTS ON THE RELEASE

Many of the specific regulatory measures addressed in the Opinion have been satisfactorily addressed by the various subsequent releases of the CFTC and the SEC (even though, in some cases, we would argue that the regulatory action taken was legally required by the MDBs' privileges and immunities, rather than being a question of prior practice, policy or comity). On the other hand, other measures (a) have been satisfactorily addressed by the CFTC but either the SEC has not addressed the issue or the position of the SEC is not clear or (b) have not been satisfactorily addressed by either the CFTC or the SEC. Finally, there is a category of measures that were not addressed in the Opinion, because they had not been definitively proposed as of the date of the Opinion, and raise issues under the Organizations' privileges and immunities. Following is a discussion of the different categories of regulatory measures and our comments on them:

1. Registration as SBSDs or MSBSPs

The central issue is, of course, the possibility of requiring the MDBs to register as SBSDs or MSBSPs.

The Definitions Release made it clear that the MDBs would not be required to register as SDs or MSPs, although it based this conclusion on mistaken concepts of immunity, as applied to the MDBs. As stated above, in the Opinion and in the World Bank/IFC letter attached hereto commenting on the Definitions Release (see the text at footnote 5), the exclusion of the MDBs from the registration requirements is dictated by the U.S. domestic law found in the Implementing Legislation and the United States' international law obligations found in the Articles. The MDBs' immunities are not determined by whether they are engaged in commercial activities, and they cannot be limited except by an Act of Congress.

The Release is not satisfactory with respect to SBSD and MSBSP registration:[18]

- With respect to SBSD registration, it indicates that it is unlikely that any foreign public sector financial institution ("FPSFI") engages in dealing activities sufficiently to come within the definition of foreign SBSD. Our comment is that this is not the test for whether the MDBs should be regulated as SBSDs. Rather, the test is whether such regulation would violate their privileges and immunities, thus causing the United States to violate its domestic law or its international law obligations. In our opinion, such regulation would.

- With respect to MSBSP status, the Release does not deal with the issue, but instead asks for additional information on the FPSFIs' security-based swap activities. We understand that the MDBs do not currently engage in security-based swap transactions at the level that would trigger MSBSP registration by a non-immune entity, but were they to do so, that information would not be relevant as to whether they should be regulated, but rather the question is whether such regulation would violate their privileges and immunities. Again, in our opinion, it would.

2. Other Direct Regulations

For the most part, the Direct Regulation measures that would flow from the SEC's regulations under the Exchange Act (a) would be addressed by not requiring the MDBs to register as SBSDs or MSBSPs or (b) are addressed by the Release.

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[18] Registration, if required, would, of course be as "foreign" SBSDs and MSBSPs, since the Release excludes the MDBs from the definition of "U.S. person".

3. Direct Regulation Equivalents

In the Opinion, we defined as Direct Regulation Equivalents a category of Regulations that, while imposed on the MDBs counterparties, are in many ways the substantive equivalents of the MDBs being subjected to Direct Regulation.

The Direct Regulation Equivalent that is the most egregious is the requirement that some of the MDBs' counterparties collect margin from the MDBs. As noted by the World Bank and IFC in their letters commenting on the various regulatory proposals and cited in the Opinion, subjecting them to the margin requirement and requiring them to post collateral to secure their swap obligations would impair their development efforts. As noted above under Background, the World Bank and IFC's CFTC and SEC Margin Release Comment Letters also point out, respectively, that the imposition of margin obligations on the MDBs is unnecessary and would be inconsistent with the CFTC's statutory mandate "to adopt capital and margin requirements that . . . [h]elp ensure the safety and soundness of the [SD or MSP] registrant" and the SEC's statutory mandate and policy goals to "help ensure the safety and soundness" of the SBSDs and the MSBSPs and "be appropriate for the risk associated with non-cleared security-based swaps held" by an SBSD or MSBSP, because given the credit-worthiness of the MDBs, obtaining collateral from them does not enhance the safety and soundness of SD, MSP, SBSD or MSBSP registrants. The Opinion's conclusion that requiring the MDBs to post collateral would violate their immunities from attachment and seizure, whether the requirement is imposed as a Direct Regulation or a Direct Regulation Equivalent measure, is summarized above under Paragraph II.4(b).

Other Direct Regulation Equivalent measures could also violate the MDBs' privileges and immunities. So far, the others that have been proposed to date appear to be the clearing, documentation and reporting requirements:

- With respect to clearing, in the Clearing Release the CFTC correctly reached the conclusion that swap transactions with the MDBs should not be subject to the mandatory clearing provisions of Section 2(h)(1) of the CEA. The SEC's counterpart release[19] did not take the same approach. As a result, provided the MDBs are not required to register as foreign SBSDs or foreign MSBSPs and the definition of "transaction conducted within the United States" is changed as suggested in sub-Paragraph 4 below, the MDBs would themselves not be subject to the mandatory clearing provisions of the Exchange Act, but transactions with regulated counterparties would. We strongly urge the SEC to follow the CFTC and exclude security-based swap transactions with the MDBs from the Exchange Act's mandatory clearing provisions.

- The MDBs have not made the case that the imposition of the documentation and reporting requirements directly on their regulated counterparties and only indirectly

[19] The SEC's Clearing Procedures Adopting Release, 77 Fed. Reg. 41602.

on the MDBs will interfere with or hinder their development efforts by, for example, increasing the costs of any essential activities, reducing their effectiveness, adversely affecting uses of capital or encouraging other Members to attempt to regulate or impose controls on the MDBs that would violate their regulatory and other immunities. As a result, we have not addressed whether such imposition would violate the MDBs' privileges and immunities.

4. Measures Not Previously Addressed

The Release proposes measures that would or could impose obligations on non-U.S. persons where the only jurisdictional nexus is the fact that they engage in transactions with the MDBs. We believe that this result is an indirect form of regulation of the operations of the MDBs that is inconsistent with their privileges and immunities. These measures are:

- Including transactions with MDBs in the determination of whether a person engaged in swap transactions exceeds the *de minimis* threshold for determining whether that person is a foreign SBSD or the threshold for a foreign MSBSP. The MDBs are excluded from the definition of "U.S. person",[20] but because some MDBs, particularly the World Bank and the IFC, given current practices, would conduct a security-based swap transaction from their offices in Washington, D.C., the transaction would likely be "solicited, negotiated, executed, or booked within the United States" on their behalf (and on behalf of their counterparty), thus causing the transaction to come within the definition of a "transaction conducted within the United States" and therefore would have to be included in the determination of the counterparty's status. Where the counterparty would not otherwise be within the scope of the application of Title VII, this is tantamount to regulation of the operations of the World Bank and the IFC, in violation of their privileges and immunities. This could be remedied by simply excluding the solicitation, negotiation, execution or booking of a security-based swap with an MDB from the definition of "transaction conducted within the United States".[21]

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[20] Although it is doubtful that there would be any doubt as to which MDBs are excluded from the definition of U.S. person, a degree of clarity would be added by listing all of the MDBs (as was done by the CFTC in the Definitions Release and the Clearing Release), rather than making them rely on the phrase "other similar international organizations".

[21] We note that in determining whether a U.S. person engaged in swap transactions exceeds the *de minimis* threshold for determining whether that person is an SD or an SBSD or the threshold for an MSP or an MSBSP, transactions with MDBs would be included. We do not believe that the same issue arises under the MDBs' privileges and immunities, because the SEC would have jurisdiction to regulate that U.S. person for other reasons and that U.S. person would not be regulated simply because it does business with the MDBs.

- Requiring that a non-registered, non-U.S. counterparty to a transaction with an MDB report that transaction. The problem would also be remedied by the change suggested in the preceding bullet point—simply excluding the solicitation, negotiation, execution or booking of a security-based swap with an MDB from the definition of "transaction conducted within the United States".

  Reporting by an entity that does not regularly engage in swap or security-based swap transactions could be quite burdensome and could discourage non-U.S. persons not otherwise subject to such requirements from doing business with the MDBs, thereby interfering with their fulfillment of their development purposes.[22]

IV. SPECIFIC COMMENTS ON THE TREATMENT OF AFFILIATES

The Release asks for comments on the question whether affiliates of the MDBs should be treated as non-U.S. persons under proposed Rule 3a71-3(a)(7) under the Exchange Act. We believe that the short answer to that question is "yes", but not so much for the limited purpose for which the MDBs are excluded from the definition of U.S. person. For the reasons set forth below, we believe that an affiliate controlled by an MDB[23] should be treated the same as the controlling MDB under the MDB's privileges and immunities, provided the controlled affiliate meets the criteria set forth below (a controlled affiliate meeting such criteria is referred to as a "Controlled Affiliate").

1. Property, Assets and Operations of MDBs Are Immune From Regulation, Whether Conducted Directly or Through Controlled Affiliates

Regulating a properly formed and governed Controlled Affiliate of an MDB would violate the MDB's privileges and immunities to the same extent that regulation of the same operations conducted directly by the MDB would. In our opinion, an MDB's privileges and immunities, whether explicitly stated or not, apply to its property and assets, as well as its operations, whether or not its property or assets are

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- [22] In the text accompanying footnote 974 of Release, the SEC summarizes the World Bank/IFC position (citing their letter defined in the Release as "World Bank letter II") with respect to reporting by counterparties as "the World Bank believed that the definition of "swap" could be qualified by a requirement that counterparties would treat such transactions as swaps solely for reporting purposes." A careful reading of World Bank letter II indicates that the comment was made in the context of counterparties which had their own reporting obligations. A similar comment can be made with respect to the summary of World Bank letter II in footnote 976.

[23] It should be noted that the question only arises in respect of "controlled affiliates", because an affiliate under common control with an MDB would most likely itself be an MDB, and the MDBs do not have any controlling affiliates, because they are controlled by their sovereign Members under the collective governance structures.

owned directly or through a Controlled Affiliate and whether or not its operations are conducted directly by it or through a Controlled Affiliate.

The foregoing is based on our reading of two sections of the MDBs' Articles of Agreement.

- First, as we indicate in the Opinion, summarized in Paragraph II.1(c) above, the express purpose of the privileges and immunities set forth in each MDBs' Articles, and indeed one of the two basic premises on which the privileges and immunities are based, is "[t]o enable [the MDB] to fulfill the functions with which it is entrusted . . . ."[24]
- Second, each MDB's Articles provide the MDB with regulatory immunity for the MDB's "property and assets" "[t]o the extent necessary to carry out the operations provided for in" its Articles.[25]

Thus, we do not believe that the specific reference to immunity for the MDB's "property and assets" (or those found in the provisions providing for attachment immunity and immunity from searches and seizures) is intended to imply that only property and assets directly held by the MDB, or only operations performed directly by the MDB, are immune. Rather, we believe that particularly each MDB's regulatory immunity is intended to make its operations, however conducted, immune from regulations and controls. Thus, if conducting a portion of its operations through a Controlled Affiliate facilitates the MDB's ability to fulfill its development mission, then the MDB's privileges and immunities are also accorded to the operations, property and assets of that Controlled Affiliate. Likewise, we do not believe that the drafters intended to bar Members from having access to the MDB's archives or bringing legal actions against the MDB, but nevertheless intended to give them access to records held by a Controlled Affiliate that is performing a function of the MDB or to permit them to sue such a Controlled Affiliate. The latter actions or regulation of a Controlled Affiliate could have an adverse effect on the MDB's ability to perform its functions just as serious as actions taken directly against the MDB or regulation of operations performed directly by the MDB.

Because Member government attempts to regulate an MDB's Controlled Affiliate would have the same adverse effect on the MDB's functions performed by the Controlled Affiliate as they would have if those functions were performed directly by the MDB, freedom from Member government interference is as necessary to the success of the MDB's operations conducted through a Controlled Affiliate as it is to the MDB's direct operations.

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24 *See, e.g.*, Section 1 of Article VII of the World Bank's Articles and of Article VI of IFC's Articles.

25 *See, e.g.*, Section 6 of Article VII of the World Bank's Articles and of Article VI of IFC's Articles.

Because the second premise of the MDBs' privileges and immunities 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, for an MDB's privileges and immunities to apply to a Controlled Affiliate:

- the Controlled Affiliate must be subject to the MDB's governance structure,
- all of its activities must be consistent with and in furtherance of the MDB's purpose and mission,[26]
- its governing instruments must restrict it to engaging in activities in which the MDB could itself engage and provide that it is not authorized to engage in any other activities, and
- the MDB must, of course, "control" the Controlled Affiliate, as that term is used in the securities laws.[27]

The premise of each MDBs' privileges and immunities of a single, collective governance system through which its sovereign Members control it and through which appropriate rules and practices are imposed by the Members not only dictates the conditions a Controlled Affiliate must meet, but it also explains why regulation of a Controlled Affiliate is unnecessary. Indeed, if the United States were to regulate an MDB's Controlled Affiliate, it would open the door to other individual Member states imposing their own regulations. This would undercut the MDB's governance systems, which are based on the participation of each Member government in the collective system as the exclusive method of governance.

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[26] We note that none of the MDBs' Articles specifically authorize them to form or create controlled affiliates. Therefore, the creation of a Controlled Affiliate by an MDB must be done pursuant to the "incidental powers" clause of its Articles. *See, e.g.*, Article III, §6 of IFC's Articles, giving IFC "the power . . . to exercise such other powers incidental to its business as shall be necessary or desirable in furtherance of its purposes." Thus, the purpose of the Controlled Affiliate must be "necessary or desirable" to the MDB's purpose and mission.

[27] *See, e.g.*, Rule 405 under the Securities Act (17 C.F.R. § 230.405). "The term control . . . means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."

2. The Supreme Court Holding in *Watters* v. *Wachovia Bank* Requires that the CFTC and the SEC Focus on an MDB's Controlled Affiliate's Purposes and Not on the MDB's Corporate Structure

Our conclusion that an MDB's Controlled Affiliate itself, as well as its property, assets and operations, are protected by the MDB's privileges and immunities, and therefore the Controlled Affiliate is excluded, to the same extent as the MDB, from regulation is not a surprising result, in light of the U.S. Supreme Court's decision in *Watters* v. *Wachovia Bank*, 550 U.S. 1 (2006). In that case, the Supreme Court held that a provision of the National Bank Act, 12 U.S.C. § 1 *et seq.* ("NBA"), that preempts state regulation of national banks applied to operations conducted by a national bank through a state-chartered subsidiary.

We believe that the holding in that case, together with the 1966 authorization by the Office of the Comptroller of the Currency ("OCC") of national banks to do any authorized banking operation through subsidiaries, which is the subject of that case, provides compelling support for our argument that the reading of MDBs' Articles should focus on the purpose of their privileges and immunities (*i.e.*, to permit them to fulfill their "functions to which [they are] entrusted") and not on the details of their corporate structure. Therefore, we provide a summary of the OCC action and the Court's holding.

a) *Action by the OCC.* In 1966, the Comptroller of the Currency ("CC") confirmed that a national bank could own a subsidiary "the functions or activities of which are limited to one or several of the functions or activities that a national bank is authorized to carry on." The CC reached this conclusion despite the fact that there was no explicit provision in the NBA authorizing a national bank to conduct any portion of its activities through a subsidiary. The CC found authorization for a national bank to conduct operations through a subsidiary "among 'such incidental powers' of the bank 'as shall be necessary to carry on the business of banking,' within the meaning 12 U.S.C. § 24 (7)" of the NBA.

In its release, the OCC stated: "The use of controlled subsidiary corporations provides national banks with additional options in structuring their businesses. National banks may desire to exercise such option for many reasons, including controlling operations costs, improving effectiveness of supervision, more accurate determination of profits, decentralizing management decisions or separating particular operations of the bank from other operations."

The OCC chided those who would make a distinction between a bank's conducting an authorized operation through a subsidiary rather than directly as "jaundiced" and "antediluvian". The OCC summed up its action as follows: "While zealous to maintain the standards which have been demonstrated to be essential for the continued safety of national banks, this Office believes care should be exercised not to cripple national banks or break down their activities by narrow and unreasonably strict construction of statutes which will result in unwisely limiting their usefulness in the transaction of business under modern conditions." (All of the quotations in the preceding paragraphs are taken from the OCC's August 25, 1966 release, which can be found at 31 Fed. Reg. 11459.)

b) *Watters* v. *Wachovia Bank*. The issue in *Watters* v. *Wachovia Bank* was whether the provision of the NBA that preempts state regulation of national banks applied to operations conducted through a subsidiary. In holding that it did, Justice Ginsburg summarized the 5-3 majority's decision as follows: "we hold that Wachovia's mortgage business, whether conducted by the bank itself or through the bank's operating subsidiary, is subject to OCC's superintendence, and not to the licensing, reporting, and visitorial regimes of the several States in which the subsidiary operates." (550 U.S. at 7.) (Emphasis added.)

The Michigan Banking Commissioner, who was seeking to regulate Wachovia's mortgage lending subsidiary, agreed that the application of those regulations to Wachovia would be preempted by the NBA, but argued that the subsidiary, a North Carolina corporation, was subject to multistate control, as well as the control of the OCC. In rejecting this and other arguments, Justice Ginsburg noted that OCC applies "the same controls whether banking 'activities are conducted directly or through an operating subsidiary.'" 550 U.S. at 17.

Justice Ginsburg went on to explain that "in analyzing whether state law hampers the federally permitted activities of a national bank, we have focused on the exercise of a national bank's powers, not on its corporate structure. And we have treated operating subsidiaries as equivalent to national banks with respect to powers exercised under federal law (except where federal law provides otherwise)." 550 U.S. at 18. (Citation omitted. Emphasis in original.) Explaining the Court's decision in another case upholding the OCC's determination of a bank's "incidental" authority to act as an agent in the sale of securities, Justice Ginsburg said: "It was not material that the function qualifying as within 'the business of banking' was to be carried out not by the bank itself, but by an operating subsidiary," i.e., an entity "subject to the same terms and conditions that govern the conduct of [the activity] by national banks [themselves]." 550 U.S. at 18. (Citations omitted.)

Justice Ginsburg, explaining the premise underlying federal preemption as being "[s]ecurity against significant interference by state regulators", went on to say: "[t]hat security should adhere whether the business is conducted by the bank itself or is assigned to an operating subsidiary licensed by OCC whose authority to carry on the business coincides completely with that of the bank", summarizing the conclusion from another case that "the determination whether to conduct business through operating subsidiaries or through subdivisions is 'essentially one of internal organization.'" 550 U.S. at 19.

We believe the holding in *Watters* v. *Wachovia Bank* is binding on the CFTC and the SEC in respect of the regulation of a Controlled Affiliate of an MDB as a matter of U.S. domestic law. Just as the premise underlying federal preemption of state regulation of national banks is "[s]ecurity against significant interference by state regulators", a premise of the MDBs' privileges and immunities is to protect them against hindrance by Members of the MDBs' development purposes. Just as Justice Ginsburg, "in analyzing whether state law hampers the federally permitted activities of a national bank, . . . focused on the exercise of a national bank's powers, not on its corporate structure", the CFTC and the SEC, in analyzing whether an MDB's Controlled Affiliate is entitled to the benefits of the MDB's privileges and immunities, should focus on the MDB's and the Controlled Affiliate's purposes and not on the MDB's corporate structure.

* * *

As indicated above, a Controlled Affiliate can be established by an MDB only if it is necessary or desirable for the enhancement of the MDB's ability to further its development activities. It must be limited to functions that the MDB is authorized to perform. The focus on MDBs' immunities should be on their purpose and not on their corporate structure. A "narrow and unreasonably strict construction of" an MDB's Articles will result in "unwisely limiting" the usefulness of a structure that the MDB's Board of Directors would have found to be "necessary or desirable in the furtherance of its purposes", thus impeding the MDB's ability to enhance its development potential. An MDB's ability to perform activities that its Board of Directors determines to be within the MDB's authorized powers and in furtherance of its mission should not turn on whether it engages in such activities directly or indirectly through a Controlled Affiliate.

3. Comments on the Specific Issue Raised by the Release

The specific issue with respect to affiliates of MDBs raised in footnote 301 of the release is whether they, like the MDBs, should be excluded from the definition of "U.S. person". The answer to that question, as indicated above, is yes. That issue, however, is not the key issue.

Excluding Controlled Affiliates from the definition of U.S. person (and excluding the solicitation, negotiation, execution or booking of a transaction with an MDB or a Controlled Affiliate from the definition of "transaction conducted within the United States") would avoid regulating transactions with non-U.S. persons not otherwise subject to regulation under the Exchange Act, which is necessary to avoid violating the MDBs' privileges and immunities. Excluding Controlled Affiliates from the definition of U.S. person does not, however, determine the other issues raised by the Release, particularly the issue whether the Controlled Affiliate would be required to register as a foreign SBSD or a foreign MSBSP. That issue must be addressed as well.

Not excluding an MDB's Controlled Affiliate from the definition of U.S. person would mean that the Controlled Affiliate could be required to register as an SBSD or an MSBSP and otherwise be regulated to the same extent as any U.S. person, all of which would, in our opinion, violate the privileges and immunities of the MDB.

Finally, we would note that to the extent that the definition of "U.S. person" determines the geographical scope of the SEC's Title VII rules, it is similar in purpose to the definition of "U.S. person" found in Regulation S under the Securities Act. For the same reasons that the Regulation S definition excludes affiliates of MDBs, so should the definition of U.S. person exclude Controlled Affiliates of MDBs for purposes of Title VII. Regulation S does not, of course, use the concept "transaction conducted within the United States", but in order to achieve the same result as under Regulation S, the Title VII definition of "transaction conducted within the United States" should exclude the solicitation, negotiation, execution or booking of transactions with MDBs or their Controlled Affiliates.

*   *   *

We appreciate the opportunity to comment on the Release. Any questions relating to these comments should be directed to Edwin D. Williamson (williamsone@sullcrom.com; (202) 956-7505).

Very truly yours,

SULLIVAN & CROMWELL LLP

(Attachment)

cc: David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

SCHEDULE A		
Name	**Article/Chapter in Articles of Agreement Containing Privileges and Immunities**	**Implementing Legislation**
European Bank for Reconstruction and Development	Chapter VIII	22 U.S.C. § 290l-6
Inter-American Development Bank	Article XI	22 U.S.C. § 283g
International Development Association	Article VIII	22 U.S.C. § 284g
Multilateral Investment Guarantee Agency	Articles 43-48	22 U.S.C. § 290k-10
African Development Bank	Articles 50-59	22 U.S.C. § 290i-8
African Development Fund	Articles 41-50	22 U.S.C. § 290g-7
Asian Development Bank	Articles 49-56	22 U.S.C. § 285g
Inter-American Investment Corporation	Article VII	22 U.S.C. § 283hh

We understand that the Bank for Economic Cooperation and Development in the Middle East and North Africa has never become active, despite the signing by the United States of its Articles of Agreement in 1996 and the authorization by its Implementing Legislation for the United States to join it (22 U.S.C. § 290o). Accordingly, it is not included in the MDBs for the purposes of this letter.

The World Bank
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

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May 17, 2012

David A. Stawick, Secretary
Commodity Futures Trading Commission
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Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-7010

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 J Robbins

Rachel Robbins
Vice President and General Counsel
International Finance Corporation

cc: Office of General Counsel, Commodity Futures Trading Commission:
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