EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-PUBLIC

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Dear Mr Radhakrishnan and Mr Brigagliano,

Relationship of Title VII of the Dodd-Frank Act to the European Central Bank and Eurosystem

We would like to commend the Commissions on the progress that has been made in preparing rules for the implementation of the Dodd-Frank Act. We steadfastly support you in this endeavour.

As you are well aware, the European Central Bank ("ECB") in particular have been consistent supporters of many of the complex policy choices now embodied in that statute, including with respect to the requirement for the mandatory central clearing of OTC derivatives, which will contribute to the reduction of systemic risk in the global financial system. We have often had a shared position with you on such issues, and repeatedly joined forces with you on them in the rigorous debates that have taken place at the various international fora where those choices were discussed.

We note that the Dodd-Frank Act rightly recognises the global nature of the financial markets, and accordingly places much emphasis on the need for international cooperation, both in terms of analysis and

implementation. We of course look forward to continuing our partnership with you throughout that cooperation and we fully expect it to result in an enduring public good on both sides of the Atlantic.

The use of OTC derivatives by international public law organisations such as the ECB - please see more details below regarding the extension to the ECB the privileges, exemptions and immunities provided to public international organizations under the International Organizations Immunities Act - as well as the national central banks of the Member States whose currency is the euro (which constitute the Eurosystem together with the ECB), in the course of their public tasks as holders and managers of the official foreign reserves of the State, is not as such specifically addressed in Title VII of the Dodd-Frank Act. As you are aware, central banks use their reserves not necessarily for commercial profit purposes but for policy purposes, and cannot be identified as ordinary market players. As you know, the ECB is in a somewhat unusual position when it comes to matters of the characterisation of its activities and, although it is a central bank, it is not subject to requirements of law that are applied to banks in general. In this respect we recall the ECB is a European institution (Article 13.1 of the Treaty on European Union).

We are therefore concerned about how Title VII of the Dodd-Frank Act will apply to the official operations of the ECB and the Eurosystem, and we would therefore appreciate some clarification from you in this regard. To the extent that your agency is preparing implementation rules to the Dodd-Frank Act, we would with all due respect seek from you due consideration to the above arguments, as well as to international comity, so that the case of International Organisations (such as the ECB) and of foreign central banks are addressed in the final regulations in a manner fitting with their official status and tasks.

In that direction, please note that the ECB's -and the Eurosystem's- mandate requires them to perform public tasks that are broadly comparable to those attributed in the United States to the Federal Reserve System, which necessarily require the ECB to conduct operations in the financial markets, including OTC derivatives. These are activities that would, if conducted by a private sector entity, necessarily fall within the ambit of Title VII of the Dodd-Frank Act. In contrast, we note that if those same transactions were entered into by the Federal Reserve System, they would be expressly excluded from the definitions of "swap" and "security-based swap" contained in the Dodd-Frank Act[1]. We set out attached some considerations on the ECB and its mandate, and its status under U.S. Law.

The point on which we seek regulatory clarification is whether official transactions such as those entered into by the ECB and by the national central banks of the Eurosystem would be captured by the definitions of "swap" and "security-based swap" contained in the Dodd-Frank Act. Clearly, our practice to date has been to transact with private sector entities on market standard documentation for swaps, but given that we have so far and would in the future only be entering into such transactions purely in execution of our public mandate – and it is to be noted that we are not authorised to enter into such transactions on any

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[1] Dodd-Frank Act, Sections 721(a)(19) and (21), including the new section 47(B)(ix) inserted into Section 1a of the Commodity Exchange Act. The new Section B(ix) states that "*any agreement, contract, or transaction a counterparty of which is a Federal Reserve bank, the Federal Government, or a Federal agency that is expressly backed by the full faith and credit of the United States*."

other basis – we suggest that the transactions that we enter into should not be interpreted and legally defined in the same way as otherwise similar transactions entered into by private commercial entities:

- First, the considerations involved in the management of foreign reserves are not amenable to control and supervision in the same way as private-sector profit-maximising transactions. Indeed, as an institution of the European Union, we are not subject to supervision or licensing requirements and suggest that it would be inappropriate to be subjected to supervisory requirements by a non-EU authority in respect of a part of our activities. In particular, we are concerned that external control of our activities might not be sufficiently sensitive to the practice of managing foreign reserves and could thus frustrate the ECB's performance of the mandate that it has been given by the TFEU.
- Second, performance of our mandate can require us to act confidentially in certain circumstances. Please note that in certain occasions central banks market activities, if subject to public disclosure and external supervision, may cause signalling effects to other market players and finally hinder the policy objectives of such actions (the CCP itself would also have a privileged view on the whole set of cleared central bank transactions). This is probably the reason behind the exemption given by Dodd-Frank Act to the Federal Reserve System (a similar exemption to the ECB and other central banks and comparable international institutions is foreseen in the proposed draft EU Regulation on Central Clearing of OTC derivatives in course of definition in Europe). Certain of the requirements of the Dodd-Frank Act, if applicable to the ECB, could compromise the ECB's ability to take such actions. In this regard, it is noted that the ECB has worked closely with the Federal Reserve System in responding to the financial crisis, and should not be compromised by implementation of the Dodd-Frank Act in its ability to respond similarly in the future.
- Third, the specificity of role and functions of central banks make their use of CCPs, and other private financial market infrastructures for that matter, a very sensitive issue, particularly in times of crisis. For instance, if a central bank were to become a clearing member of a CCP it would need to contribute to the CCP default procedures. In case of crisis, this could force a central bank to eventually absorb other participants' and possible the CCP's losses, thereby raising sensitive moral hazard issues.
- Fourth, this may introduce inconsistency between EU and US legislation concerning the central bank obligations to use designated CCPs

The abovementioned arguments apply *mutatis mutandis* to the national central banks of the Eurosystem.

As you of course know, Congress has vested the Commissions with the rulemaking authority to further define certain terms, including "swap" and "security-based swap"[2], and such joint rulemaking on the

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[2] See Dodd-Frank Act § 721 (b) ("*The [CFTC] may adopt a rule to define – 1) the term "commercial risk"; and 2) any other term included in an amendment to the [CEA]...*"). Section 761 (b) of the Dodd-Frank Act provides similar definitional authority to the SEC and allows the SEC to, "*by rule, further define*" any term included by the Dodd-Frank Act in the Exchange Act.

definition of the terms "swap" and "security-based swap" is to be done in consultation with the Board of Governors[3]. In light of the above, we therefore respectfully ask the Commissions to exercise their definitional authority under the Dodd-Frank Act to define the terms "swap" and "security-based swap", as used in the Commodity Exchange Act and Securities Exchange Act, respectively, to exclude any agreement, contract or transaction a counterparty of which is a Public International Organisation such as the ECB, or indeed a national central bank of a market economy.

We stand ready to elaborate on any of the matters raised above, including with respect to the size and risk management of our US dollar interest rate derivatives portfolio activities to the extent that this would be helpful to you.

Yours sincerely,

[signed]	[signed]
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Director General	General Counsel
Directorate General Payments and Market Infrastructure	Directorate General Legal Services

Cc: Jeff Marquardt (Board of Governors of the Federal Reserve System)

Scott Alvarez (General Counsel Federal Reserve Board)

[3] Dodd-Frank Act, Section 712(d)(1).

The ECB and its mandate

The ECB and the Eurosystem have originally been established pursuant to the Treaty Establishing the European Community (the "EC Treaty") among the 27 Member States of the EU, as amended in 1993, and continues to exist pursuant to Article 282.1 of the Treaty on the Functioning of the European Union ("TFEU") that replaced the EC Treaty in 2010.

The basic tasks to be carried out through the Eurosystem are set out in Article 127(2) of the TFEU, providing that the ECB, together with the Eurosystem, shall conduct the monetary policy of the Union. The other basic tasks carried out through the Eurosystem include, *inter alia*, the responsibility to conduct foreign exchange operations consistent with the exchange-rate policy for the euro in relation to non-EU currencies (such as the U.S. dollar) and to hold and manage the official foreign reserves of the Member States (the greatest portion of them being U.S. currency, managed in the U.S.). To this end, the ECB has, pursuant to Article 30 of the Statute of the ESCB and of the ECB – which is primary European Union law as it is annexed to the TFEU – been provided by the national central banks of the EU Member States that have adopted the euro with foreign exchange reserve assets.

In performance of its public responsibilities, the ECB may carry out any operation in the financial markets, including OTC derivatives. The conduct of these operations aims at the fulfilment of Eurosystem's objectives as laid down in the TFEU, which are not of commercial nature but policy-oriented. This entail, however, the use of market techniques; for example, as regards ECB foreign reserves management, in 2008, the ECB extended the range of instruments it already used to plain vanilla interest rate swaps denominated in US dollars. The ECB's portfolio is, consistent with the ECB's obligations as a public institution entrusted with managing reserve assets, very conservatively managed[4].

Status of the ECB in the United States

The President of the United States of America has, by Executive Order 13307 of May 29, 2003, extended to the ECB the privileges, exemptions and immunities provided to public international organizations designated by the President under the International Organizations Immunities Act (22 U.S.C. 288 and 288f-5).

In this regard, it is worth recalling that the International Organizations Immunities Act was specifically amended (by Public Law No: 107-278) so as to provide authority for the President to accord immunities to the ECB. In moving to pass the bill (Congressional Record, 24 September 2002 H6484) that became Public Law No: 107:278, Representative Leach (as sponsor in the House of Representatives) noted that it was symbolically important "*to underscore support for the establishment of the European Union*". He continued that according to the ECB the status of an international organisation "*is entirely equitable and*

[4] See attached article on ECB portfolio management that appeared in the April 2006 issue of the ECB's Monthly Bulletin.

reasonable and amounts to the kind of mutual accommodation that we should be emphasising at a time when so much friction is building between the United States and the European Union on a host of commercial and political issues", and that it "*is incumbent on those on this side of the Atlantic to express our support and respect for this historical movement and for the institutions necessary to make it a cohesive success*". The above statements by Representative Leach are as relevant today as they were when made.

Moreover, while designation as an international organisation accords important immunities on an organisation, it is noted that there is no right to such designation. Indeed, the International Organizations Immunities Act gives authority to the President both to designate an organisation as an international organisation, and broad discretion to revoke such designation: specifically, by 22 USC 288: "…*The President shall be authorized, if in his judgment such action should be justified by reason of the abuse by an international organization or its officers and employees of the privileges, exemptions, and immunities provided in this subchapter or for any other reason, at any time to revoke the designation of any international organization under this section, whereupon the international organization in question shall cease to be classed as an international organization for the purposes of this subchapter*".