

European Commission
Directorate-General for Justice and Consumers
European Commission
1049 Brussels
BELGIUM

22 May 2018

Ladies and Gentlemen

Assignment of claims and transactions in intermediated securities

We are writing in relation to:

- (1) the Proposal for a Regulation of the European Parliament and of the Council on the law applicable to the third-party effects of assignments of claims (the “**Claims Proposal**”);¹ and
- (2) the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the applicable law to the proprietary effects of transactions in securities (the “**Securities Communication**”).²

The Claims Proposal and the Securities Communication were published together by the European Commission on 12 March 2018 as part of its delivery of actions to support completion of the 2015 Action Plan on Capital Markets Union (CMU). The Commission has invited feedback on the Claims Proposal.³ We take this opportunity to respond to that invitation. We note that the Securities Communication is a closely related measure, as acknowledged by the Commission,⁴ and we comment briefly on that at the end of this letter.

The International Swaps and Derivatives Association, Inc. (ISDA) is the principal trade association for the global derivatives markets.⁵ We focus in this letter on issues of relevance

¹ COM(2018) 96 final.

² COM(2018) 89 final.

³ https://ec.europa.eu/info/law/better-regulation/initiatives/com-2018-96_en.

⁴ Claims Proposal, pp 1 and 11-12; Securities Communication, p 1.

⁵ Registration Identification Number 46643241096-93 in the EU Transparency Register. Since 1985 ISDA has worked to make the global derivatives markets safer and more efficient. Today ISDA has more than 900 member institutions from 68 countries. These members

to the derivatives market. We participated in the Commission's Expert Group on Conflict of Laws on Securities and Claims, which met during the course of 2017, and we responded in detail to the Commission's Consultation Document on Conflict of Laws Rules for Third Party Effects of Transactions in Securities and Claims, which was issued on 7 April 2017 for response by 30 June 2017 (the "**2017 Consultation Document**").⁶ Our response to the 2017 Consultation Document was submitted on 29 June 2017.⁷

The Claims Proposal

We support the objective of providing legal certainty in relation to the cross-border assignment of claims by promoting uniform conflict of laws rules throughout the European Union. Our specific points in relation to the proposal are as follows:

1. We support the approach taken by the Commission in the Claims Proposal, which we understand is intended to apply the law of the assigned claim to (a) cash credited to an account in a credit institution and (b) claims arising out of financial market transactions. This is reflected in Article 4(2) of the draft Regulation appended to the Claims Proposal. We support this approach in relation to the assignment of claims arising in the derivatives market for the reasons set out in some detail in our response to the 2017 Consultation Document, in particular in response to Question 25.
2. Our principal concern regarding the Commission Proposal is that we believe that the intended scope and drafting of Article 4(2) are not sufficiently clear.
3. In relation to Article 4(2)(a) of the draft Regulation the words "credited to an account in a credit institution" should be deleted as they are encompassed within the definition of "cash" in Article 2(h). Also cash should not be limited to money credited to an account with a credit institution but, at a minimum, should include cash credited to an account with an investment firm or any other form of financial institution or insurance company.
4. In relation to Article 4(2)(b) of the draft Regulation, that provision relies on the term "financial instrument" as specified in Section C of Annex I of Directive 2014/65/EU, which governs the types of financial instrument that are subject to regulation under MiFID II,⁸ which is too narrow to encompass all of the relevant claims that might be

comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Further information about ISDA, its membership and its activities is available on the Association's website: www.isda.org.

⁶ The Commission's Expert Group and Consultation are discussed at pp 13-16 of the Claims Proposal.

⁷ A copy of the ISDA response is available on the ISDA website at the following link: <https://www.isda.org/2017/06/29/isda-response-to-european-commission-consultation-on-conflict-of-law-rules-for-securities-and-claims/>.

⁸ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (recast) [2014] OJ L173/349.

subject to voluntary assignment in the derivatives market. It should be clear that all claims arising between parties to an agreement entered into the wholesale derivatives market should be within the scope of the rule in Article 4(2)(b) of the draft Regulation, including, and in particular, a close-out amount arising under a master agreement. A master agreement is not, however, itself a “financial instrument” as defined in the draft Regulation, nor is a financial collateral arrangement. A claim for the delivery of margin or collateral should be within the scope of Article 4(2)(b), but such a claim is not necessarily “cash” nor is it necessarily a “claim arising from a financial instrument”. It is a claim arising under a financial collateral arrangement, which, as just noted, is not a “financial instrument” as defined in Section C of Annex I to MiFID II. We are also concerned that the words “arising from” are not sufficiently clear.

5. We note that the Commission’s clear view in its discussion of the proposed Regulation in the Claims Proposal is that intermediated securities are not “claims” within the scope of the Commission Proposal and that there is, therefore, no overlap between the proposed rules for the voluntary assignment of claims and the conflict of laws rules relating to the transfer of intermediated securities. We agree with this in principle, but we think that the definition of “claim” should be amended to put this point beyond doubt.

The Securities Communication

We are disappointed that the Commission has taken the view that a Communication is a sufficient response to the current lack of certainty as to the correct interpretation of the existing rules in the Acquis concerning the law applicable to the third-party effects of a transfer of intermediated securities.

6. The first point to note is that the existing rules do not cover one of the most common cases of a transfer of intermediated securities, namely, in connection with a sale of securities.
7. Article 9(2) of the Settlement Finality Directive⁹ only applies in relation to settlement systems, Article 9 of the Financial Collateral Directive¹⁰ only applies to a transfer of financial collateral in the form of intermediated securities and Article 24 of the Winding Up Directive for Credit Institutions¹¹ only applies for purposes of the winding up of a credit institution.
8. We agree that the rules in these different EU instruments take a common approach, namely, a focus on the “location” of an account, but that approach is flawed, as the Securities Communication itself acknowledges. Moreover, there are differences of

⁹ Directive 98/26 of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems [1998] OJ L166/45.

¹⁰ Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements [2002] OJ L168/43.

¹¹ Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions [2001] OJ L125/15.

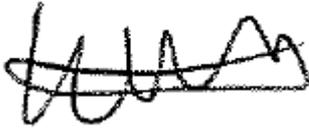
detail between the rules and different approaches to interpretation of those rules in different Member States,¹² which does lead to substantial legal uncertainty.

9. The Commission, in its discussion of the relationship between the Claims Proposal and the Securities Communication, refers to a lack of “tangible evidence of material risk in respect of securities”, but this is, with respect, not the right way to approach the problem. Major financial institutions are currently spending significant amounts of money on legal due diligence to address the legal uncertainty caused by the lack of a uniform rule across Europe in relation to the third-party effects of a transfer of intermediated securities, and it was this substantial legal uncertainty which motivated the development of the Hague Securities Convention. Moreover, it would not be beneficial for the financial markets or the wider economy to wait until “material evidence” emerges as a result of substantial losses incurred due to substantial uncertainty as to the relevant governing law during a future financial crisis.
10. We acknowledge in our response to the 2017 Consultation Document that there appears to have been a failure to achieve consensus among EU Member States as to the approach taken by the Hague Securities Convention, but we also feel that measures can and should be taken to develop a uniform rule that is clear, consistent and certain, even if that means an approach other than that taken in the Hague Securities Convention. We do, however, believe that there should be room for an approach acceptable to all EU Member States that adopts the Hague Securities Convention approach while also addressing, via appropriate regulatory requirements, the objections that have been raised within the EU to some aspects of the Hague Securities Convention approach.
11. Finally, we note that the Commission concedes in the Securities Communication that there is uncertainty as to meaning of “located” or “maintained” in relation to an account or register. For the reasons set out in our response to the 2017 Consultation Document, the difficulties are more profound than appears to be acknowledged by the Commission in the Securities Communication. The terms “located” and “maintained” simply cannot apply literally to an account or register, unless the account or register is identified (via an artificial rule) with a physical manifestation of the account relationship (such as the location of an office or branch of the securities intermediary, the location of relevant infrastructure, etc.) Further examples are given in our response to the 2017 Consultation Document. We feel compelled to observe that the Commission Communication has missed an important opportunity to deal with a continuing source of substantial legal uncertainty for the financial markets.

¹² As acknowledged in the Commission Communication at p 4.

We would be grateful to have the opportunity to discuss these issues further with you, if you would find that of assistance. We would also be happy to provide you with any further information you may require regarding the operation of the derivatives markets or any other matter. If you have any questions or comments, please contact either of the undersigned.

Yours truly



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