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1 August 2005

BY E-MAIL

Directorate General Internal Market
European Commission
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Dear Sirs

Green Paper on Financial Services Policy (2005-2010)

We are grateful for your kind invitation to comment on the Green Paper on Financial Services Policy (2005-2010) published by the Commission on 3 May 2005.

ISDA is the global trade association representing leading participants in the privately negotiated derivatives industry. ISDA was chartered in 1985, and today has more than 600 member institutions from 47 countries. These members include most of the world's major financial institutions that deal in privately negotiated derivatives, as well as many corporations, governmental entities and other end-users that use over-the-counter derivatives to manage efficiently the financial market risks inherent in our business activities. A current list of ISDA's members, as well as other information about ISDA and its activities, is available on our website at www.isda.org.

As you know, we have been actively involved over many years in consultations with the Commission and other European and national authorities on financial services issues, including in relation to the many elements of the Commission's Financial Services Action Plan launched in 2000 (the FSAP).

The scope of the Green Paper is broad and raises many important issues. We will, of course, be continuing our longstanding dialogue with the Commission on most of these issues on future occasions and in a variety of fora. Following detailed discussions among our members regarding

the Green Paper, we have decided in this response to limit our response as an international trade association to two key issues for the integrity of the financial markets, namely, the enforceability of close-out netting and the need for greater certainty in relation to the law applicable to securities held with intermediaries. We expect that a number of our members will be responding individually to the Commission in relation to a number of the other issues raised by the Green Paper.

Netting legislation in the European Union

We were surprised to see no mention in the Green Paper of possible measures to strengthen and promote convergence of the legal regimes for close-out netting in the various member states of the European Union, particularly in the accession countries, many of which are currently contemplating netting legislation.

We note that the Securities Expert Group convened by the Commission to report on the impact of the FSAP on the European securities market highlighted in section 4.3 of its Final Report of May 2004 the need for greater harmonisation of netting regimes. The Securities Expert Group noted that inconsistencies among the current close-out netting regimes could constitute a barrier to further integration of the European market for financial services. The Group also referred to the need to provide minimum standards or benchmarks for effective and efficient netting of transactions.

The Financial Collateral Arrangements Directive (the FCAD)¹ set out a set of minimum standards or benchmarks for legal regimes for financial collateral arrangements, and this has, where implemented, brought not only an improvement of the individual national regimes for financial collateral but also a convergence of national regimes on a common set of fundamental principles.

In our view, a similar European instrument is necessary for close-out netting, in particular to promote convergence of, and eliminate, as far as possible, inconsistencies between existing close-out netting regimes in Europe and also to provide a set of core principles to guide the accession countries in implementing netting legislation.

We note the close relationship between close-out netting and financial collateral. Close-out netting forms the legal basis of the most common type of financial collateral arrangement used in the European privately negotiated derivatives market, namely, title transfer financial collateral arrangements. For example, the 1995 ISDA Credit Support Annex (Bilateral Form – Transfer), which is based on title transfer, is widely used in the European market.²

The FCAD acknowledges this by requiring, in Article 7, that member states shall ensure that a close-out netting provision can take effect according to its terms, notwithstanding the onset of

¹ Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

² See the ISDA Margin Survey 2004, available on the ISDA website (<http://www.isda.org>) for empirical data on financial collateral arrangements, including title transfer based arrangements entered into under the 1995 ISDA Credit Support Annex (Bilateral Form – Transfer) governed by English law.

insolvency proceedings and without regard to certain other matters that might otherwise affect close-out netting. But the FCAD does not itself give any guidance as the basic principles that should underlie an effective modern regime for close-out netting.

As noted above, ISDA has long experience of dialogue with national legislative and regulatory authorities on close-out netting, and we are currently participating in on-going consultations on netting legislation in various countries in Europe as well as in Asia and the Americas. ISDA is the sponsor and publisher of the 2002 Model Netting Act and ISDA is always sensitive to the need to frame legislation in a manner appropriate to and sympathetic with the specific legal and cultural context of each country. For this reason, ISDA works closely not only with national authorities on these issues but also with its local members and other local financial market participants.

On the basis of this experience, we believe that we have a good deal of collective expertise to offer in helping to frame appropriate principles for modern netting regimes. In our letter of 24 February 2004 to Pierre Delsaux of the Commission in his role at that time as Chairman of the Securities Expert Group, we outlined in some detail why we believe that a Netting Directive would be a valuable measure to promote further integration of the European market in financial services. For convenience of reference, we attach a copy of that letter.³

We have previously had the opportunity to discuss these issues with members of the Commission, and we would be delighted to continue that dialogue. We urge the Commission to add the adoption of a Netting Directive to the Final Policy Programme to be presented by the Commission in the form of a White Paper in November 2005.

*Hague Securities Convention*⁴

We note that the Commission is reconsidering its proposal for signature of the Hague Securities Convention as the result of the representations of some member states and the European Central Bank. We note that the Commission is intending to conduct a legal assessment evaluating the concerns raised and will then decide whether changes are needed to the current signature proposal.

For the reasons set out in our letter to Commissioner Bolkestein of 26 July 2004, we remain of the view that a legal assessment is not necessary. The process that was followed by the Hague Conference on Private International Law and led to the adoption of the text of the Hague Securities Convention was open, transparent and inclusive, with ample opportunity for thorough discussion by all interested member states, interested European bodies and other observer

³ To underline further the importance of these issues for the financial markets, we note that the European Financial Markets Lawyers Group, which meets regularly under the auspices of the European Central Bank, prepared and submitted to the Commission in October 2004 its report entitled "Protection for Bilateral Insolvency Set-off and Netting Agreements under EC Law". We do not comment in this letter on the analysis or specific conclusions set out in that report, but we agree with its general aim of promoting further measures to enhance legal certainty and consistency across the EU in relation to insolvency set-off and close-out netting.

⁴ Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary adopted by the Hague Conference on Private International Law in December 2002, but not yet in force.

organisations, including European and international trade associations. There was substantial input from the financial markets to ensure that market realities were taken into account. A detailed explanatory report was produced and is available.

We note the view previously expressed by some to the Commission that current European legislation (for example, Article 9 of the FCAD) provides sufficient certainty on the private international law issues addressed by the Hague Securities Convention. While current European rules adopted within the past few years provide some comfort, they are not adequate for the longer term. For this reason, we believe that a measure such as the Hague Securities Convention is needed for the European financial markets, and that it would be in the interest of Europe for the Convention to be promoted in other parts of the world, to provide certainty for European financial market participants in their cross-border dealings outside the EU.

Since the Commission has decided to conduct a legal assessment, we renew our offer, made in our letter to Commission Bolkestein, to assist in providing any information or other assistance you may require from an international financial market perspective.

We hope that the foregoing is helpful in your consideration of these issues in the context of the formulation of the Final Policy Programme for Financial Services. We would be pleased to discuss the issues raised in this letter with you in more detail. Please do not hesitate to contact the undersigned or Peter Werner at ISDA's European office in London (pwerner@isda.org).

Yours faithfully,

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