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Mr David Wright
Director Financial Markets
Internal Markt DG
European Commission
Avenue de Cortenberg,107
B-1049 Bruxelles

3 February 03

Dear Mr Wright,

Working document of the Commission Services on Capital Requirements for Credit Institutions and Investment Firms- Comments prepared by LIBA and ISDA.

The International Swaps and Derivatives Association (ISDA)¹ and the London Investment Banking Association (LIBA)² (jointly, the Associations) are pleased to enclose a detailed commentary on the Commission Services' working document on capital requirements for credit institutions and investment firms. We welcome the Commission Services' offer to conduct a structured dialogue with representative organisations.

The following comment letter concentrates largely on the capital treatment of investment business. This commentary is a conscious choice to address issues which the Basel Committee itself has only marginally touched upon. The focus of the Basel reform has been upon the banking sector, and even more narrowly, upon the banking book. Proposals to amend the trading book treatment of firms are limited in the QIS3 Technical Guidance and many of the suggested changes are merely broad brush fixes, whereas the complexity of the issues at stake would have warranted greater care and caution. This is particularly apparent in some aspects of credit risk mitigation.

¹ ISDA represents leading participants in the privately negotiated derivatives industry and includes most of the world's major financial institutions, as well as businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage the financial risks inherent in their economic activities. ISDA has taken a keen interest in the Basel Accord reform since 1998, and is one of the very few international trade associations to have established a dialogue with the main Basel Committee Working Groups. Our contributions to the reform process encompass proposals for a more risk sensitive treatment of credit risk, credit risk mitigation in its various forms and operational risks. More information about ISDA and copies of our submissions to the Basel Committee can be obtained from our website at www.isda.org.

² The London Investment Banking Association (LIBA) is the principal trade association in the United Kingdom for firms in the investment banking and securities industry which base their European activities in London. LIBA has been closely engaged in the Basel dialogue since the outset of the capital review process.

Against this background, and considering that the new Capital Adequacy Directive (CAD3) will apply to investment firms in the EU as well as to banks undertaking investment services, the Associations have deemed it imperative to focus on issues of direct relevance to the lines of business common to investment firms and banks. These include the consolidation rules, the Trading Book treatment, Large Exposures requirements and the new operational risk charge. Our concerns in these various fields are highlighted and possible solutions are offered. Importantly, we have sought to maintain consistency with the Capital Accord draft wherever possible. When our proposals entail changes to the Accord itself, they have been shared separately with the Basel Committee. (See ISDA's comments on the QIS3 Technical Guidance, Annex 2 and the joint LIBA-BBA response to the Basel Committee, Annex 3).

Our response is set in the context of several high level principles that we believe are essential to the process for completing the capital review: namely parallelism so far as appropriate with Basel, flexibility in the legislative instrument, and need for assurance for the industry of consistent application of the new capital regime. Our comments further include a discussion of the Commission's articulation of the Supervisory Review Process where we highlight the need for supervisory convergence and transparency.

It is our hope that the Commission Services will find this letter useful. We are also sending this letter to M. Thébaud as well as copying to Ms Savino, Mr Pearson and Mr Cross.

Yours sincerely,

Katharine Seal
Director
LIBA

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ISDA