

ISDA

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BY POST AND BY E-MAIL

31 August 2004

DG MARKT G1
European Commission
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Dear Sirs,

We are grateful for your kind invitation to comment on the Communication dated 28 April 2004 from the Commission to the Council and the European Parliament entitled "Clearing and Settlement in the European Union – The way forward". We are also grateful for the opportunity we had to discuss these issues with you during our meeting with you on 27 July 2004.

The International Swaps and Derivatives Association, Inc. (*ISDA*) is the global trade association representing leading participants in the privately negotiated derivatives industry, a business which includes interest rate, currency, commodity, credit and equity swaps, options and forwards, as well as related products such as caps, collars, floors and swaptions. ISDA was chartered in 1985 and today numbers over 600 member institutions from 46 countries on six continents. Roughly half of ISDA's members are European institutions. Of the 20 primary members represented on ISDA's current Board of Directors, 10 are European institutions and all of the remainder have significant operations in Europe. ISDA has been involved for many years in legal, regulatory, risk management and market practice issues affecting the European financial markets, and ISDA values the constructive dialogue it has had over that time with the Commission.

ISDA's interest, in particular, in clearing and settlement issues is long-standing, and ISDA has followed attentively and supported the Commission's work on these issues in its earlier Communication on clearing and settlement (2002), as well as the work of the Giovannini Group and of other international bodies such as The Group of Thirty (G30).

In this regard, we wish to bring to your attention that a systemically important part of daily settlements in the European market (and elsewhere in the world) relate to:

- hedging in the securities markets of derivatives trades (not only hedging of securities-related derivative transactions but also hedging of other types of financial risk in the securities markets – interest rate risk, for example, is often hedged in the government debt securities market);
- settlement of securities repurchase (repo) and securities lending transactions (which include a derivative element in the form of the forward settlement leg);
- physical settlement (delivery of securities) in connection with physically-settled swap, option and forward transactions on equities, debt securities and other financial instruments, including physically-settled credit derivative transactions;
- settlement of financial collateral obligations, supporting the increasing proportion of cross-border derivatives activity that is collateralised; and
- clearing and settlement of derivative transactions themselves (any work on the operational, legal or other aspects of clearing and settlement of securities will inevitably affect clearing and settlement of derivatives).

Of course, hedging goes both ways, and a significant proportion of securities trading activity in the underlying (or "cash") market is hedged in the derivatives market. It is therefore important to ensure, during your on-going work, that the potential impact of derivatives activity on clearing and settlement and the impact of clearing and settlement issues on the derivatives market are kept firmly in mind.

One of ISDA's core missions is to promote measures to strengthen legal certainty in the financial markets by developing sound modern legal regimes in the leading derivatives markets and promoting compatibility through convergence at the level of fundamental principles between those regimes. To this end, ISDA and its members have devoted significant resources to promoting financial law reform, in particular to strengthen close-out netting and the legal framework for financial collateral arrangements, through a variety of means, including: lobbying countries to introduce close-out netting legislation; publication of a Model Netting Act and providing information on market practice and other support to national and regional authorities on close-out netting issues; commissioning and maintaining a growing library of legal opinions on close-out netting and collateral enforceability; and promoting collateral law reform through the activities of ISDA's Collateral Law Reform Group. Accordingly, ISDA has a particular interest in the Legal Certainty Project discussed in the Communication.

ISDA strongly supports the Commission's work on clearing and settlement and commends the Commission for acknowledging the centrality of these issues to the future integrity and efficiency of the European market for financial services. In particular, ISDA supports, among others, the Commission's objectives of (1) liberalising and integrating European clearing and settlement by, for example, eliminating the Giovannini Barriers (referred to in the Communication) and (2) promoting a level playing field. In relation to these objectives and the other objectives set out in the Communication, ISDA also supports the Commission's proposed practical initiatives, including the establishment of the Clearing and Settlement Advisory and Monitoring Expert Group (the CESAME Group) and the proposed expert groups on legal and tax issues.

The Commission's Communication raises many complex and inter-dependent issues. We will not, therefore, comment further at this stage on the detail of the Communication. We have had the opportunity to review, in some cases in draft, a number of the submissions that have been made to the

Commission in response to your Communication by various European financial market associations, and many of these have gone into some detail on issues such as the importance and proper establishment of a common regulatory/supervisory framework, governance issues and competition law issues. We believe that there is a reasonable degree of consensus, but also, at any rate currently, some apparent differences of view on key issues. Further detailed study and open dialogue is therefore crucial.

It is in our view fundamental, given the complexity and importance of the issues raised by the Communication, that you continue to ensure careful and detailed consultation with the financial industry and that the process of development of a new European framework for clearing and settlement be as transparent as possible. We know that the Commission is following closely other international work on clearing and settlement, including the work of the G30 and, in particular in relation to the legal certainty issues the Hague Securities Convention and, as acknowledged in part 3.1 of the Communication, the on-going work of UNIDROIT on substantive legal rules regarding securities held with an intermediary.

We reiterate our support for your work on these issues, and we would be pleased to assist, whether in conjunction with the work of the CESAME Group, the Legal Certainty or Taxation experts groups, or otherwise. In particular, we would be delighted to provide any further information or assistance regarding international financial market practice, that will help to ensure that any future European legislation on these issues promotes a deeper, more liquid and more integrated European market in financial services by strengthening, among other things, the legal certainty of internal and cross-border securities settlements. Please feel free to contact any of the undersigned if you have any questions or desire any further information.

Yours faithfully,

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