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BY E-MAIL

European Commission  
Directorate General Internal Market and Services  
Financial Services Policy and Financial Markets  
Financial Markets Infrastructure  
Rue de la Loi  
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BELGIUM

For the attention of: Mr Tomas Thorsén

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Dear Sirs

**Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements**

We hope that you will permit us to address you once again on the Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements (the **Directive**), now that you are in the process of preparing your Evaluation Report on its implementation, following your consultation earlier this year with the Member States and with the private sector.

You may recall that we wrote to you on 3 April 2006 with our own response to your kind invitation to comment on the issues raised in your questionnaire for the private sector. We have also had the benefit of reviewing the comments of other financial market associations and of the European Financial Markets Lawyers Group, and it seems to us that there is a reasonable consensus as to both the strengths of the Directive itself and also the areas where the Directive and its implementation in a number of Member States could be improved for the benefit of strength, depth and liquidity of the European financial markets.

Our intention in writing this letter is not to repeat the specific points raised in our letter of 3 April 2006 but to set out, in a form which we hope you will find useful, some suggestions for

amendments to the Directive which we believe would go a long way toward addressing the principal areas for improvement of the legal regime created by the Directive. As we indicated in our letter of 3 April 2006, the Directive has already brought significant benefits to the European financial market, promoting certainty, simplicity and efficiency, to the benefit of all parties and all arrangements within its scope. Regrettably, there continue to be some issues as to the scope of the Directive, both as a matter of policy (which types of entities should be covered) and as to interpretation of the text (what constitutes collateral provided being “under the control” of the collateral taker).

We believe that our suggestions below represent a consensus view of the private sector regarding issues in the Directive and its implementation that should be addressed. This is not an exhaustive list, and other points are made in our submission of 3 April 2006 and by other financial market associations on the Directive and its implementation. But the following are core recommendations of the financial markets, and we strongly urge the Commission to consider and adopt them:

1. **The Directive should be amended to eliminate the opt-out in Article 1(3) of the Directive.** For reasons that are given in detail in our prior submissions to the Commission during the consultations that preceded adoption of the Directive, corporate entities, including small- and medium-sized enterprises, should not be excluded from the benefits of the Directive in terms of access to financial services. The certainty, simplicity and robustness of the legal regime created by the Directive increase the access of those who fall within the scope of the Directive to wholesale financial services and permit those services to be obtained on a more cost-effective basis (since the provision of collateral means that the price charged to such a market participant does not need to include an excess premium for credit risk).
2. **The Directive should be amended to eliminate the proviso to Article 1(2)(e) of the Directive.** There are many participants in the wholesale financial market who do not fall within one of the categories set out in points (a) to (d) of Article 1(2), and bilateral arrangements between participants both falling within (e) are not uncommon. Diversified financial groups often have a variety of regulated and unregulated entities within the group for various purposes, and it is not uncommon for two such entities from different groups to enter into bilateral trading relationships in relation to financial derivatives. Another example is the energy sector where energy trading companies trade with each other on bilateral and privately negotiated or over-the-counter (OTC) basis in relation to energy-linked derivatives and, indeed, often in relation to interest rate and currency derivatives as well, relating to the financing of their energy businesses. There is no policy reason why such arrangements should not benefit from the certainty and simplicity created by the Directive. Quite the contrary. The extension of the Directive to such arrangements would strengthen the integrity, efficiency and liquidity of the European financial market, for the same reasons that the Directive currently does this for entities within the current limited scope of the Directive.
3. **Close-out netting in Europe should be strengthened by amendment of Article 7 to extend its scope to close-out netting provisions outside the context of financial**

**collateral arrangements and to set out the core principles that national legal regimes for close-out netting should embody.** We have previously urged the Commission to consider a European instrument on close-out netting (for example, in our letter to Commission Bolkestein of 26 July 2004, our letter to you of 1 August 2005 on the Green Paper on Financial Services and in our letter of 3 April 2006, referred to above. We believe that the current review of the Directive and its implementation offers an opportunity to achieve the twin goals of facilitating the establishment of effective close-out netting regimes in the new Member States (and candidate countries) as well as convergence of the existing close-out netting regimes on a core set of principles. We will shortly be forwarding to a more detailed proposal in this regard in relation to the possible amendment of Article 7.

4. **The definition of what constitutes being “under the control” of the collateral taker for purposes of Article 2(2) should be clarified.** The Directive brings legal certainty and operational efficiency to collateral arrangements within its scope. Some uncertainty, however, remains as to whether delivery of collateral under certain types of arrangements satisfies the “control” element of Article 2(2), and this has proven to be an area of differential implementation across the European Union.
5. **Article 9 of the Directive should be amended to bring the conflict of laws rule for intermediated securities in line with the conflict of laws rule set out in the Hague Securities Convention.** We welcomed the Commission’s recent Legal Assessment of the Hague Securities Convention, and we believe that amendment of Article 9 provides an important opportunity to bring Community law in line with the Hague Securities Convention.

While we have not formally consulted with other financial market associations in preparing this letter, we have had numerous informal discussions with other financial market participants and observers, and we have had the opportunity, as noted above, to review the submissions made by other associations and groups to the Commission earlier this year. We believe that our core recommendations above reflect a broad consensus view of such participants and observers as to measures that would be strongly beneficial to the European financial markets.

To give just one example (although others could be given), we believe our recommendations 1 to 4 above are consistent with those urged by the European Federation of Energy Traders (EFET) in its letter to the Commission of 30 March 2006 (that letter does not discuss the Hague Securities Convention). An additional point made in the EFET letter, which we would also endorse, is the extension of the benefits of the Directive to commodity trading transactions, including transaction involving physical settlement. The same arguments as those marshalled above as to improved legal certainty and efficiency militate in favour of such an extension in scope of the Directive. We can see no sensible policy reason against such an extension.

As always, we are grateful for your attentiveness to the view of the financial markets, and we are keen to assist your deliberations in any practical way that we can. Should you require any further information or wish to discuss any of the issues above with us further, please do not hesitate to contact Peter Werner in London on +44 20 7330 3550.

Yours faithfully,

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