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23 June 2009

Ladies and Gentlemen

Consultation on legislation on legal certainty of securities holding and dispositions

The International Swaps and Derivatives Association (**ISDA**) is grateful for the opportunity to respond to the Commission's consultation document of 16 April 2009 on legislation on legal certainty of securities holding and dispositions (the **Consultation Document**). We note that the Consultation Document is informed by the impressive and detailed work of the Commission's Legal Certainty Group, as set out in its report 'Solutions to Legal Barriers related to Post trading within the EU' of August 2008 (the **LCG Report**).

ISDA is the global trade association representing leading participants in the privately negotiated derivatives industry, a business that 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 currently has more than 830 member institutions from 57 countries on six continents. More than half of the total membership is based in the European Union and neighbouring countries and a significant portion of the rest active participants in the European financial markets as dealers, service providers or end users of derivatives. Promoting legal certainty for cross-border financial transactions through law reform has been one of ISDA's core missions since it was chartered in 1985.

ISDA's interest in clearing and settlement of securities is long-standing, and ISDA has followed closely and supported the Commission's work on these issues, for example, as reflected in Commission Communications on clearing and settlement issues in 2002 and 2004 (which, of

course, reflected the benefit of the work of the Giovannini Group, which itself met under the auspices of the Commission), and we supported the establishment of the CESAME Group, the Legal Certainty Group and the FISCO Group. We have also followed closely the work of the Hague Conference on Private International Law in relation to the law applicable to rights in intermediated securities and the work of UNIDROIT since 2002 in relation to a draft convention on substantive rules regarding intermediated securities (the **Draft UNIDROIT Convention**).

ISDA's membership includes a wide variety of financial market participants, most of whom are users of securities clearing and settlement services. Many are also financial intermediaries of various types who are involved in various capacities in providing securities clearing and settlement services. Derivatives market participants engage in: 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 lending transactions; 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 default swaps and other credit derivatives; and delivery of financial collateral in the form of securities under security and title transfer financial collateral arrangements. Not surprisingly, given the size and importance of ISDA's European membership, a large proportion of securities settlements undertaken globally by or for the benefit of ISDA members occur in the financial markets within the European Union. The vast majority of these transactions involve intermediated securities.

Having established the importance of these issues for ISDA members and the close interest with which ISDA and its members have followed these issues over a number of years, ISDA does not have an official view on many of the questions of detail covered by the Consultation Document. This is because ISDA's mission is principally concerned with the over-the-counter (OTC) derivatives market and the integrity, efficiency and stability of that market. Other associations and, of course, individual firms are more directly concerned with the integrity, efficiency and stability of securities clearing and settlement infrastructure and processes.

ISDA's members, as noted above, include issuers, account providers and account holders (and, of course, any individual member may act in all of these capacities), with a wide variety of sizes, interests, relative specializations and national and international perspectives. There are therefore, inevitably, some differences of view among ISDA members on a number of the questions of detail covered by the Consultation Document. For this reason, rather than attempting to provide specific answers to each question, we thought it would be better to highlight the following points that arise out of or relate to the Consultation Document, on which we believe that there is a general consensus of ISDA members:

1. The problems addressed by the LCG Report and the Consultation Document

We believe that the LCG Report and the Consultation Document, building on the work of the Giovannini Group, correctly identify, in principle, the legal difficulties preventing greater efficiency in, and further integration of, the European securities market. We support the view that greater harmonization of the laws of EU member states would be

beneficial. We also support the view that the focus should be on harmonizing the legal effect of a transfer of intermediated securities and that it is not necessary fully to harmonize the conceptual legal nature of intermediated securities (or “book-entry securities” as they are termed in the LCG Report). In other words, we support the functional approach recommended by the LCG Report, which appears to be reflected in the Consultation Document.

2. The position of the account holder vis-à-vis the issuer of securities

We do not comment in detail on the questions addressed in part 2 of the Consultation Document, but we support the view that the ultimate account holder (that is, the account holder who ultimately bears the economic risk of a securities position) should enjoy, as far as possible, all of the economic rights of a direct holder of the securities, including the right to dispose of its economic position, to receive distributions of income and other rights made by the issuer and to exercise voting rights, if any, attached to the securities.

3. An account holder’s right of set-off against the issuer of securities

We believe that it is entirely consistent with the principle discussed in paragraph 2 above that the ultimate account holder should also be able to exercise a right of set-off against the issuer of securities if it has such a right available to it as a matter of the law applicable to the relevant securities and/or the law applicable to the issuer, for example, in the event that the issuer is subject to insolvency proceedings. In other words, an account holder should be able, as far as possible, to exercise a right of set-off against the issuer if it would be able to exercise such a right if it were a direct holder of the securities.

This is consistent with Article 30 of the October 2008 Draft UNIDROIT Securities Convention (discussed further below), and we are surprised that this point is not discussed in either the LCG Report or the Consultation Document. Many financial market participants have in place specific contractual arrangements in order to effect a set-off of, for example, an ‘out-of-the-money’ position under an ISDA Master Agreement (that is, a position under which that market participant would owe money to the other party on a net basis if a close-out were to occur) with a particular counterparty against a holding of debt securities issued by that counterparty. Since, as noted above, the vast majority of securities are transferred and held as book-entry securities, it is important the legal framework for book-entry securities should facilitate such a right of set-off as far as possible, subject, of course, to creating no greater right of set-off than a direct holder of the same securities would have.

We acknowledge that there are operational issues that could make the exercise of such a right of set-off difficult to effect in practice, but this is irrelevant to the question of legal principle. Operational issues can be tackled separately and in due course.

4. The scope of future legislation on the legal effect of book-entry securities

We strongly agree with the view expressed by the UK Financial Markets Law Committee in its letter of 1 June 2009 to Mr Jorgen Holmquist, your Director General, that the legal regime for book-entry securities established by any future European legislation should apply to all account providers and not only to those regulated by a competent authority. It is not conducive to legal certainty to have different legal regimes apply depending on the regulatory status of an account provider. Currently regulatory powers in Europe should be sufficient to deal with systemic issues raised by the activity of unregulated account providers. Furthermore, there may well be some account providers that should not, in principle, be required to be regulated as financial intermediaries. Many trustees, for example, will be account providers, in the functional sense used in the LCG Report, without there currently being any policy reason to regulate them as financial intermediaries.

5. Consistency with the Draft UNIDROIT Convention

As noted above, we have followed closely the development of the Draft UNIDROIT Convention, which we believe has the potential to deliver significant benefits in increasing legal certainty in relation to intermediated securities globally. The LCG Report recognizes the importance of coordinating European legislative action in this area with the Draft UNIDROIT Convention. The LCG Report also recognizes that the same issues driving the desire for greater legal certainty in relation to intermediated securities in the European financial markets also drive the desire for greater legal certainty globally. The global financial markets operate across borders, including across the border between the European Union and the rest of the world.

It is clearly beneficial to European participants in the global financial market that the same principles should apply in respect of their holding and transfer of book-entry securities in systems in the US, Japan, Switzerland and elsewhere around the world, including in the so-called 'BRIC' economies, namely, Brazil, Russia, India and China.

The LCG Report acknowledges this in paragraph 1.4.1, and we merely wish to underline our agreement with this view.

6. Conflicts of law

We strongly agree that it is important to have a clear conflict of laws rule for determining the law applicable to the 'proprietary' aspects of the transfer and holding of intermediated securities. It is for this reason that considerable resources were invested over a number of years by a number of countries in the work of the Hague Conference on Private International Law on this topic. This work resulted in the Hague Securities Convention, which we agree establishes a different rule to the conflict of law rules set out in Article 9(2) of the Settlement Finality Directive (**SFD**) and Article 9(1) of the Financial Collateral Arrangements Directive (**FCAD**).

That, however, is not, in our view, a good reason not to consider conforming European law to the approach of the Hague Securities Convention, which is informed by considerably more detailed work, debate and open consultation than went into either of the EU rules just cited. We acknowledge that the European rules are pragmatic and provide sufficient guidance in most cases, but they are nonetheless limited and do not provide the certainty provided by the Hague Securities Convention rule. The limitations of the current European approach are carefully and thoroughly dissected by the Explanatory Report to the Hague Securities Convention.

We are aware, of course, of the political difficulty faced by the Commission in relation to the Hague Securities Convention and do not wish to look backwards. But we do not believe that the current European PRIMA rule (which is, in any event, not entirely consistent as between the SFD and the FCAD versions) provides a satisfactory long-term rule.

We therefore urge the Commission to use its influence to move the Member States forward toward a workable solution that will allow the European Union to adhere to a globally acceptable rule. The Hague Securities Convention represents the best basis available for such a rule, offering the greatest certainty. We believe that the objections that have been raised to it to date are, in part, based on misconceptions, while other objections can best be addressed by appropriate regulatory measures, without disturbing the conceptual legal framework laid down by the Convention.

We would be pleased to discuss these issues with you further should you find that helpful. We look forward to seeing the Commission's legislative proposal in relation to the intermediated securities in due course, which we will study with great interest. In the meantime, please do not hesitate to contact either of the undersigned if you have any questions regarding the points raised above or desire any further information about the interest of derivatives market participants in these matters.

Yours faithfully

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