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BY E-MAIL

European Commission  
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Dear Sirs

**Public consultation on the reorganisation and winding-up of credit institutions**

We are grateful for your kind invitation to respond to your questionnaire regarding Directive 2001/24/EC on the reorganisation and winding up of credit institutions (the **Directive**). We believe that the introduction of the Directive was a valuable step towards establishing greater legal certainty and greater efficiency in the reorganisation and winding of credit institutions operating in the European Union, but we are aware of certain difficulties caused by apparent gaps and ambiguities in the Directive. We welcome the opportunity to assist the Commission in identifying appropriate solutions to these difficulties.

The International Swaps and Derivatives Association, Inc. (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 800 member institutions from over 50 countries, with more than half of the total membership 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. As you

know, ISDA has been an active participant in the Commission's public consultations over the years on a variety of legal and regulatory measures, and has followed the evolution of the European legal and regulatory framework for the single market in financial services with close attention.

You raise a number of important questions in parts 1 and 2 of the questionnaire, and we trust that you will have detailed responses from public sector and private sector consultees across Europe. We do not propose ourselves, therefore, to attempt to address all of the questions but to focus on those issues of most immediate concern to the derivatives industry from an international perspective.

### *Part I of the questionnaire*

Question 10(a). As an association, we do not have a view on the form the coverage of investment firms should take and whether it should be under the Directive or a separate directive (although many of our members and other associations with a different focus may have particular views on this point), but we do believe it would be desirable to extend the benefits of the Directive in some form to investment firms and collective investment undertakings. It does seem anomalous to us that they are not currently covered by the Directive or by Council Regulation EC 1346/2000 on insolvency proceedings (the **Insolvency Regulation**).

Question 10(f). As you have identified in the consultation paper, there is some uncertainty in the market concerning the proper interpretation of Articles 23, 24, 25 and 26 of the Directive, and these are the provisions of the Directive of most immediate concern to the derivatives markets. We would be happy to assist the Commission in relation to further technical work on clarifying the scope, application and intended interaction of these provisions.

A couple of questions which arise, for example, regularly in discussions of Article 25 of the Directive are the precise scope of the definition of "netting agreement" and the proper interpretation of the reference to the "law of the contract". In the latter case, there is some debate as to whether what is intended is the insolvency law of the jurisdiction whose law is applicable to the netting agreement (which in most cases would be the law expressly chosen by the parties to govern the netting agreement, but might in some circumstances be the law applicable under Article 4 of the Rome Convention of 1980 on the law applicable to contractual obligations in the absence of choice), or whether it is the general law of that jurisdiction including its law of contract and its law of insolvency and other relevant laws, or whether it is the general law of that jurisdiction excluding its insolvency law, or whether it is merely its law of contract, excluding other areas of general law applicable prior to insolvency and its insolvency.

The foregoing debate regarding the scope of the term "law of the contract" appears to be more active in some EU member states than others, and this may be partly due to differences in the different official language versions of the Directive.

We also agree that the provisions of Articles 23, 24, 25 and 26 of the Directive do not appear to cohere with the treatment of these and related issues in other European instruments, most notably the Insolvency Regulation, Directive 2001/17/EC on the reorganisation and winding up of

insurance undertakings and Directive 2002/47/EC on financial collateral arrangements (the **Collateral Directive**). We have raised this point previously with the Commission, and we are aware that others have as well, including the European Financial Markets Lawyers Group, which produced a fairly extensive study of the treatment of the concepts of "set-off" and "netting" in the various official language versions of a number of European instruments a couple of years ago.

In various prior communications and meetings with the Commission, we have urged the Commission to consider developing and proposing a European instrument on contractual netting, to establish a set of base principles comparable to the set of base principles established by the Collateral Directive, which have proved so successful in converging, simplifying and therefore strengthening the legal framework for financial collateral across the Community. In connection with this, we have suggested that the treatment of the concepts of close-out netting and set-off should be made consistent where they apply across the *acquis communautaire*.

### *Part II of the questionnaire*

The issues considered in Part II of the questionnaire are important, but other consultees would be better qualified and better placed to comment on the issues raised there in detail. We do, however, wish to raise one point for consideration as part of this project, namely, the issue of cross-affiliate netting.

Currently there are some challenges to be overcome before it is possible to establish an effective cross-affiliate netting arrangement, namely, where obligations owed by one insolvent company may be netted against obligations owed to another member of the same group of companies (whether that other member is itself solvent or insolvent). There are, however, considerable benefits to be gained in terms of reduction of credit risk and therefore systemic risk from permitting the netting of exposures across a group of related companies, and we understand that this is intended to be the subject of further consultation among the members of the Basel Committee on Banking Supervision. In the Commission's future work on the detailed issues raised in Part II of the questionnaire, we strongly recommend that this issue of cross-affiliate netting and the related topic of cross-affiliate set-off be borne in mind. We would be happy to assist, of course, in any future such work from the perspective of the international derivatives markets.

We have had the opportunity to review in final draft form the joint response of the London Investment Banking Association (LIBA), the Futures and Options Association (FOA) and the European Securitisation Forum (ESF), and we support their observations and conclusions, subject to the specific comments above.

If we can be of further assistance in relation to your work on the issues raised in the questionnaire or otherwise in relation to the ongoing review of the Directive and related issues, please do not hesitate to contact Peter Werner in London on +44 20 7330 3550 or Edward Murray of Allen & Overy LLP, London (tel. +44 20 7330 1837; e-mail: [ed.murray@allenoverly.com](mailto:ed.murray@allenoverly.com)), the Chairman of our Collateral & Financial Law Reform Group.

Yours faithfully,

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