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Lord Browne-Wilkinson
Chairman
Financial Markets Law Committee
c/o Bank of England
Threadneedle Street
London EC2R 8AH

Dear Lord Browne-Wilkinson,

Property Interests in Investment Securities

We are grateful for your kind invitation to review and comment on the Financial Markets Law Committee (*FMLC*) paper entitled "Analysis of the need for and nature of legislation relating to property interests in indirectly held investment securities, with a statement of principles for an investment securities statute", published on 5 July 2004 (the **Paper**). The Paper addresses issues of great importance to the financial markets.

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. Additional information on ISDA, its European membership and its interest in the development of European and UK law affecting the financial markets is set out in the Annex to this letter.

One of ISDA's core missions is to promote measures to strengthen legal certainty in the financial markets. To this end, ISDA and its members have devoted significant resources to promoting financial law reform, with particular attention to strengthening close-out netting and the legal framework for financial collateral arrangements.

ISDA has participated in a number of consultations in the United Kingdom, including recent consultations by HM Treasury, the Financial Services Authority, the Bank of England and the Law Commission of England and Wales on legal and regulatory matters affecting the European

financial markets, and, of course, we have had a number of opportunities to contribute to participate in discussions organised by the FMLC on a variety of legal issues of importance to the financial markets.

We have a particular interest in these proposals as a significant proportion of financial collateral arrangements entered into under ISDA's standard form documents are governed by English law.¹ Financial collateral in the form of investment securities is, in the vast majority of cases, transferred through and held with financial intermediaries, therefore implicating the issues dealt with in the Paper.

More generally, most cross-border OTC derivatives trading is done under an ISDA Master Agreement, governed by either New York law or English law. In the European market, in particular, English law is the predominant governing law chosen to govern transactions entered into under the ISDA Master Agreement. Much of this trading involves settlement by physical delivery of securities or related hedging in physical securities positions, particularly in the equity derivatives, bond derivatives and credit derivatives sectors. OTC derivatives are also extensively used in conjunction with structured financings and other financial arrangements involving securities custody and settlement. Hence, ISDA is deeply committed to promoting law reform to improve legal certainty in relation to the transfer and holding of securities in book-entry form through modern clearing and settlement systems.

In responding to any consultation regarding a national law reform proposal, ISDA as a trade association normally defers to national legal experts within our membership in relation to the technical detail of the proposals and its interrelationship with and impact upon existing law. Instead, we focus, as a general rule, on the policies underlying the national law reform and the intended effects.

In this regard, we note that the FMLC working group advising the FMLC in relation to the Paper included a number of individuals who are closely involved in the financial markets and have a detailed knowledge of the issues of most concern to our members. This, of course, inspires confidence among our members.

Following your invitation to comment on the Paper, we circulated the Paper to interested members, and based on subsequent discussions within the membership, we are pleased to relay to you the following conclusions:

- We believe that the Paper sets out a sound basis for clarifying the legal framework for property interests in investment securities held with financial intermediaries.

¹ See the ISDA Margin Survey 2004, available from the ISDA website (<http://www.isda.org>) for some empirical data on financial collateral arrangements entered into under the 1995 ISDA Credit Support Annex governed by English law (the *English Annex*) and the 1995 ISDA Credit Support Deed governed by English law (the *English Deed*). The English Annex, which creates a title transfer financial collateral arrangement under English law, is the second most widely used form in the cross-border market for privately negotiated derivatives after the 1994 ISDA Credit Support Annex governed by New York law. The English Deed, which creates a security interest under English law, has traditionally not been favoured because of various difficulties and inconveniences arising under English law prior to the implementation in the United Kingdom of the EU Directive on financial collateral arrangements. Following the implementation of that Directive in the United Kingdom, the English Deed, appropriately amended, is being used more frequently.

- ISDA members would, in principle, support legislation in the UK to clarify the issues raised by the Paper, and ISDA members in principle support the solutions suggested in the Paper. ISDA would, however, strongly urge the FMLC to urge, in its turn, relevant government officials responsible for any legislative efforts in this area to ensure that any draft legislation is the subject of broad and open consultation. We believe that it is in the interests of all to ensure that the concerns of the financial markets are properly taken into account in the framing of the detail of the legislation.
- Principle 8 (Set-off) of the Principles for Investment Securities Statute is of particular importance to the financial markets. Not only should this principle be reflected in any legislation in this area, but we believe that additional work should be done further to strengthen and clarify the availability of set-off of debt securities held through intermediaries against debts owed by a creditor against an insolvent issuer of those securities.
- Any legislative efforts in this area should be undertaken in coordination with work being undertaken by the European Commission in connection with its initiative on clearing and settlement, and in particular the work of its "Legal Certainty Working Group" established, we understand, to address the same sorts of concerns as are addressed in the Paper. We find it encouraging that the Legal Certainty Working Group includes, acting in their personal capacities, three individuals who were also involved in the FMLC's Working Group and two of whom are currently members of the FMLC itself.
- We also believe that any legislative efforts in this area should be undertaken in coordination with work being done by the UNIDROIT working group on harmonised substantive rules regarding securities held with an intermediary.

We are grateful that the FMLC is taking a close interest in these issues, which are of great importance to the financial markets. We would be pleased to discuss any of the issues raised above, or indeed any related issue, with you in more detail. If you would find that helpful, please do not hesitate to contact the undersigned.

Yours faithfully,

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Copies to: Joanna Perkins, Secretary, Financial Markets Law Committee
Kirsty Devonport, Clifford Chance