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BY POST AND BY E-MAIL

Credit Institutions Reorganisation and Winding Up Consultation
Banking and General Insurance Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

E-mail: alice.galvin@hm-treasury.x.gsi.gov.uk

Dear Sirs,

Consultation on Implementation of the Credit Institutions Reorganisation and Winding Up Directive (2001/24/EC)

We are grateful for the opportunity to respond to your consultation document "Implementation of the Credit Institutions Reorganisation and Winding Up Directive" (November 2003) (the *Consultation Document*), which includes as Annex A draft regulations (the *Draft Regulations*) to implement the Credit Institutions Reorganisation and Winding Up Directive (2001/24/EC) (the *Directive*) in the United Kingdom and as Annex B - A Partial Regulatory Impact Assessment.

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. 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.

ISDA has actively supported financial law reform in Europe for many years and has participated in a number of European and national consultations on European instruments affecting the financial markets. Promoting legal certainty for cross-border financial transactions through law reform is one of ISDA's key objectives. A considerable proportion of the resources of ISDA and its members is devoted to acquiring and updating legal opinions from a wide range of jurisdictions on netting, set-off and financial collateral arrangements. The Directive, as implemented in each Member State of the

European Community, will have a significant impact on the cross border financial agreements dealt with in those opinions where one or both of the parties is a European credit institution.

The principal purposes of the Directive

We understand that the principal purposes of the Directive are:

- ◆ to simplify the administration of a cross-border insolvency affecting a European credit institution by providing for the law of a single Member State, namely, the home state of the relevant credit institution, to govern the related insolvency proceedings throughout the European Community, subject to certain important exceptions designed, among other things, to ensure the legal certainty of cross-border financial arrangements; and
- ◆ to ensure equal treatment of creditors wherever they may be based in the European Community.

The Directive includes a variety of practical measures relating to mutual recognition, co-operation and communication between relevant authorities and insolvency officials in the various Member States where an insolvent credit institution may have operations. In addition, it includes a number of derogations from the basic rule that the home Member State's insolvency law governs the insolvency proceedings of the insolvent credit institution.

In responding to the Consultation Document, we defer to national legal experts in the various legal jurisdictions of the United Kingdom as to the technical detail of the practical measures and the derogations referred to above, and how those measures and derogations impact upon and relate to current insolvency legislation in the United Kingdom. In this regard, we understand that the City of London Law Society Insolvency Law Sub-Committee and the Financial Services and Markets Legislation City Liaison Group (in which ISDA participates) are intending to or have already responded to the Consultation Document. We have had the opportunity to review proposed comments by each group in draft form, and, although we have not conducted a detailed consultation with our members in relation to the Consultation Document, we believe that our members would be broadly supportive of the comments being raised by each of these groups.

In our comments, we wish to comment principally on three aspects of the proposed implementation, as reflected in the Consultation Document and the Draft Regulations, namely:

- (i) the derogations in Draft Regulations 26, 28, 31, 33, 34 and 35;
- (ii) the treatment of non-EC credit institutions; and
- (iii) the treatment of non-EC creditors.

Legal certainty and derogations from the principal rule of the Directive

The principal purpose of the derogations is, of course, to enhance legal certainty by protecting the expectations of parties that their contractual arrangements will be enforced in accordance with the relevant governing law. We note, for example, that in Paragraph 78 of the Consultation Document, you

state that Draft Regulation 34 is “intended to ensure strict legal certainty in respect of [netting] agreements”.

Given our mission, we are, unsurprisingly, particularly concerned with the certainty of netting and collateral arrangements for privately negotiated derivative transactions. Our members, however, clearly also have a strong interest in ensuring that related arrangements (for example, transactions in regulated markets as referred to in Article 27 of the Directive and draft Regulation 29) enjoy a high level of legal certainty.

We therefore would suggest that the Draft Regulations could be further strengthened in various ways to enhance the legal certainty that the derogations are intended to establish. In this regard, we note that the Treasury has taken the approach, which was also taken with the implementation of the Directive on the reorganisation and winding-up of insurance undertakings, of following the language of the Directive with generally minimal (although occasionally significant) variations.

While this approach clearly has some advantages, it would be helpful if the opportunity were taken to clarify, for example, whether the law referred to in Draft Regulation 34 is simply the contract law of the relevant jurisdiction or somehow encompasses the insolvency law of that jurisdiction as well (which would be highly problematic and therefore injurious to legal certainty if insolvency law were somehow meant to apply even in the absence of insolvency proceedings in the relevant jurisdiction).¹ This issue has already proved troubling to certain lawyers construing the implementation of the Directive in at least one other Member State. Given the large number of cross-border netting agreements in the European market that are governed by English law, it would be particularly helpful if the UK implementation of this rule was particularly clear.

It would also be helpful to clarify the relationship between Draft Regulations 28 and 34 in any case where the relevant netting agreement is based on contractual set-off, it being understood, of course, that some netting agreements are not necessarily based (or at least not wholly based) on contractual set-off but on other legal mechanisms such as the single agreement approach reflected in the 1992 and 2002 versions of the ISDA Master Agreement.²

We note that there have been a number of recent legislative efforts which address similar or overlapping issues, admittedly for different purposes, but with the consequent danger of inconsistency or even conflict between the resulting rules. Without being able to go into detail in this letter, we would respectfully suggest that careful attention be paid to the potential interaction of the derogations in the Draft Regulations with comparable provisions of the Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, the Insurers (Reorganisation and Winding Up) Regulations 2003 and the Financial Collateral Arrangements (No. 2) Regulations 2003. For example, the rules

¹ A similar issue arises in relation to Article 6 of the Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, although with the added complication that, in contrast to the position under the Directive, secondary proceedings may occur in the jurisdiction of the law applicable to the insolvent debtor's claim.

² Sometimes also referred to as the “flawed asset” approach, under the single agreement approach the transactional obligations of the parties are discharged upon the designation of an early termination date and replaced by a single close-out obligation calculated by reference to (but only by reference to) the termination values of the terminated transactions. Separate claims are not preserved post-default in relation to each terminated transaction, and therefore there is no set-off in the strict sense. There may, however, be adjustments to the net close-out claim by set-off, for example, of amounts that became due and remained unpaid at the time of early termination.

relating to the location of and law applicable to interests in book-entry securities and other proprietary interests recorded in an account or on a register would be a fruitful area for further study and clarification.

We appreciate your careful attention to these issues and your acknowledgement of the importance of legal certainty in relation to netting, set-off, collateral and repo agreements.

Non-EC credit institutions and non-EC creditors

In relation to the treatment of non-EC credit institutions, we would welcome clarification as to the intended effect of treating the UK branch of a non-EC credit institution as a “UK credit institution” for purposes of the Draft Regulations. We assume that this does not mean a departure from the long and honourable tradition in UK insolvency law, notwithstanding the universal basis of its insolvency jurisdiction, of *de facto* deference to and co-operation with insolvency proceedings in the home jurisdiction of a multibranch insolvent party.

We also assume that there will be no impact on the basic and longstanding UK principle of non-discrimination against creditors of an insolvent UK entity, regardless of whether the creditor is based in a Member State of the European Community or elsewhere in the world. In this regard, although we do not comment specifically on the technical measures in the Draft Regulations, we urge you to ensure that differential treatment of EC and non-EC creditors (or more precisely European Economic Area (EEA) and non-EEA creditors, as reflected in the Draft Regulations) does not arise as a result of such measures or otherwise.

We thank you once again for the opportunity to respond to the Consultation Document. If you would like to discuss any of the points raised in this letter, please do not hesitate to contact Edward Murray of Allen & Overy (ed.murray@allenoverly.com), who is the Chairman of our Collateral Law Reform Group, or the undersigned.

We stand ready to provide any further information or assistance, for example, regarding international financial market practice, that may aid in the process of implementation in the United Kingdom of this important European internal market measure.

Yours faithfully,

Dr Peter M Werner
ISDA European Office
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ANNEX

The International Swaps and Derivatives Association

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 was chartered in 1985 and today numbers over 600 member institutions from 46 countries on six continents. These members include most of the world's major institutions who deal in, and leading end-users of, privately negotiated derivatives as well as associated service providers and consultants. A list of ISDA's members is available from the website at <http://www.isda.org>.

Nearly half of ISDA's members are European institutions, with the next largest group being North American, followed by members from the Asia-Pacific region and South America. The majority have significant operations in the City of London and/or regular dealings with other market participants operating from the City of London. Of the 20 primary members represented on ISDA's current Board of Directors, 11 are European institutions, all with significant operations in the City of London. ISDA's current Board of Directors includes senior bankers from Barclays Capital, the Royal Bank of Scotland, and Standard Chartered Bank.

ISDA's members therefore have a deep and longstanding interest in the legal and regulatory framework for financial transactions in Europe and specifically in the United Kingdom, particularly given the importance of the City of London as an international financial centre and the fact that a large proportion of cross-border derivatives documentation is governed by English law.³

ISDA has participated in a number of consultations by HM Treasury, the Financial Services Authority and the Bank of England on legal and regulatory matters affecting the European financial markets and is grateful for each opportunity to express financial market concerns about legislative initiatives affecting financial markets, to provide information about financial market practice where helpful in shaping legislative policy and generally to encourage appropriate and market-sensitive modernisation of legal regimes in this area.

³ For further information on ISDA generally, please consult our website at <http://www.isda.org>.