

# ISDA

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For the attention of Philipp Paech

Dear Sirs,

## **UNIDROIT Study Group on Harmonised Substantive Rules Regarding Securities Held with an Intermediary**

We read with great interest your Position Paper of August 2003 on Harmonised Substantive Rules Regarding Indirectly Held Securities. As you know, we have been following the development of this project by UNIDROIT since its inception, having commented, in response to your kind invitation, in our letter to you of 6th September, 2002 on the scope of the project. The issues addressed in the Position Paper are of fundamental and pressing concern to the financial markets, including, of course, the market for privately negotiated derivative transactions.

As you know, the International Swaps and Derivatives Association (ISDA) is the global trade association representing 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.<sup>1</sup> 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.

ISDA's involvement in financial market law reform initiatives, including the public consultations on the EC Directive on financial collateral arrangements and the Hague Convention on the law applicable to certain rights in respect of securities held with an intermediary, was described in our letter of 22nd September, 2002. This work is co-ordinated by interested members through our Collateral Law

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<sup>1</sup> For further information on ISDA and its activities, please consult our website at <http://www.isda.org>.

Reform Group, which was founded in early 1999. This Group, in addition to publishing the position paper "Collateral Arrangements in the European Financial Markets: The Need for National Law Reform" in December 1999,<sup>2</sup> has participated in every significant European and international financial law reform consultation affecting collateral arrangements since 1999, as many as well as many important national consultations. Many of these projects, such as the Hague Convention and the UNIDROIT project, have important implications beyond financial collateral arrangements. ISDA members have been pleased to provide valuable financial industry insights and supporting information about financial market practice to these projects.

We believe that UNIDROIT has an important role to play in promoting sound principles for legal regimes governing securities held by intermediaries, by providing a forum for comparing existing regimes that have attempted to address these issues directly,<sup>3</sup> as well as deepening thinking on and proposing sensible developments to these solutions. Just as the Hague Convention deals with the private international law aspects of securities held by intermediaries in greater depth than any existing legislative solution, UNIDROIT has the opportunity to perform the same role in relation to the substantive law aspects.

We do not propose to comment in detail at this stage on specific propositions in the Position Paper. We would, however, like to make the following general observations:

1. We applaud UNIDROIT for the clarity and thoughtfulness of the Position Paper. It is an extremely useful survey of the issues and underlying policy concerns as well as a useful canvassing of possible solutions.
2. We echo the broad division of the issues into, on the one hand, questions of the **internal soundness** of each legal regime as well as, on the other hand, **compatibility** of legal regimes. ISDA has consistently supported this dual approach to the issues given the cross-border nature of the financial markets and of the financial collateral arrangements underpinning much of that trading. Of course, as the Position Paper suggests, defining what degree of compatibility is necessary or feasible requires further detailed study, including full harmonisation of detailed substantive rules (perhaps the least likely result politically), harmonisation at the level of basic rules or general principles (leaving detail to individual countries - likely to be the optimal result politically), mutual recognition of other regimes (likely to be less than satisfactory as a full solution), and other lesser degrees of co-ordination between countries.
3. In relation to paragraph 3.10 of the Position Paper, we believe that a uniform rule is required for the protection of property representing account holders' interests in investments securities held by an intermediary in the event of the intermediary's insolvency. This is important to ensure market confidence in the integrity of systems for the holding of securities by intermediaries.

Finally, we would like to make one important point regarding a matter of process. We believe that it is critical to the credibility and therefore future success of this project that the Study Group has access to regular and on-going input from active members of the financial industry. We are impressed with the credentials and experience of the members of the Study Group, but we note that it principally consists of legal academics and practitioners. While this may be right given the nature of the project, we believe that this should be supported by regular input from a consistent group of industry professionals. We believe that this is important in addition to the *ad hoc* fact-finding meetings on these issues that UNIDROIT has conducted and will be conducting in various parts of the world. We would be happy to suggest possible

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<sup>2</sup> Originally published on-line, a revised edition in hard copy was published by ISDA in March 2000. It was accompanied by a country report, summarising the current state of the legal regime for financial collateral arrangements, in each of the 15 member states of the European Union as at the end of 1999.

<sup>3</sup> For example, existing legislation in Belgium, France, Luxembourg, New Zealand, as well as the various provinces of Canada, and the various States of the United States (via the Uniform Commercial Code).

members for an industry advisory group to be associated with the work of the Study Group. We believe that the Hague Convention benefited immeasurably from its regular consultations with a stable group of industry practitioners.

As is hopefully apparent, we strongly support the work of UNIDROIT on this project, and we stand ready to provide any further information or assistance, for example, regarding financial market practice, that may aid in achieving the goals of this important initiative. If you would like to discuss any of the issues in this letter, please do not hesitate to contact either of the undersigned.

Yours faithfully,

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