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Mr Philip Lowe
Director General
European Commission
Directorate-General Competition
B-1049 Brussels
BELGIUM

Dear Mr Lowe

Draft revised Commission Notice on the application of State aid in the form of guarantees

We are grateful for the opportunity to comment on the draft revised Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees (the **Draft Notice**). We appreciate the aims of the Draft Notice and the importance of the issues it addresses. We wish to comment on certain aspects of the Draft Notice which may affect the cross-border derivatives markets in Europe. We hope that this will assist you and your staff in ensuring that the Draft Notice, when finalised, achieves its objectives without any unintended consequences for the European 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 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. ISDA has been an active participant in the Commission's public consultations over the years on a wide 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.

We have had the opportunity to review the comments of the International Capital Market Association, Ltd (**ICMA**) in its letter to DG Competition of 25 September 2007. The focus of those comments was, of course, the potential impact of the Draft Notice on state guarantees which support borrower's obligations under bonds and similar instruments. We are in full agreement with the comments of ICMA as they relate to debt securities. The debt markets are closely related to and interdependent with the derivatives markets, and the points raised by ICMA either apply directly to cross-border derivatives transactions in Europe supported by a State guarantee or apply indirectly through the impact on State-guaranteed debt issues.

In particular, we endorse the comments of ICMA concerning the gap between the policy objectives of the Draft Notice and the allocation of risks between Member States and the private sector in relation to the validity of a State guarantee and the mismatch between that allocation of risks and the tools available to mitigate them. We also support ICMA's proposals as to possible solutions to these risks and agree that their preferred solution, set out in Annex 2 to their letter of 25 September 2007, is the best approach.

We understand the importance of the State aid rules and the need for guidance from the Commission on the application of those rules. In common with ICMA, we are not proposing "absolute protection of all lenders from the illegality of a state guarantee in all circumstances". Of course, where ICMA refers to lenders in relation to State-guaranteed debt issues, we would refer to creditors of the borrowers under related hedge arrangements, effected by the use of derivatives.

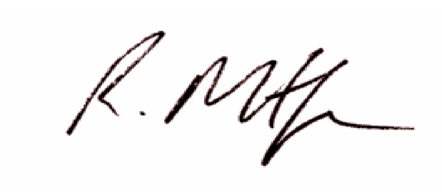
The vast majority of debt issues are hedged using derivatives, for example, to manage the interest rate risk and, where relevant, currency risk to which the issuer of the debt may be exposed by virtue of the issue or the way it is funding repayment of the issue. Not only does hedging reduce the risk to borrower of adverse movements in interest rates and currency exchange rates, and potentially other risks such as credit risk (depending on the precise terms of the borrowing), but it also, through legitimate arbitrage of credit markets, permits borrowers to access investors (for example, in a foreign currency market) that might not otherwise be available to the borrower and also permits borrowers to access funds more cheaply (for example, by effectively "locking in" via the hedge a sub-LIBOR cost of funding).

In light of the foregoing, we share ICMA's concerns regarding the fixed maximum amount in 3.2(b) of the Draft Notice and the "80% limit" rule in 3.2(c) of the Draft Notice. We note the absence of the exemption for "bonds and similar instruments" which appears in the existing notice 2000/C71/07. Not only do we believe that this exemption should be restored, for the reasons given by ICMA, but we think that it is important to clarify and extend it to ensure that it covers hedging arrangements relating to a debt issue falling within the exemption. For the reasons mentioned above, the hedging of a debt issue forms an integral part of the overall financing and to have the 80% rule apply in relation to the hedging but not the debt issue itself would create a distortion in the economics of the financing and in the allocation of risks. To that extent, we strongly urge the Commission to take the opportunity to clarify an area of uncertainty under the existing notice, while at the same time accommodating the exemption for the debt markets requested by ICMA.

Finally, we have also had the opportunity to review the comments of the Bank of England's Financial Markets Law Committee (the **FMLC**) in the letter dated 28 September 2007 to you from Lord Woolf, the Chairman of the FMLC. From an industry point of view, we would endorse the legal certainty concerns of the FMLC. As noted above, one of our central missions has always been to promote legal certainty in order to strengthen stability of the cross-border financial markets and reduce costs and eliminate brakes on efficiency and liquidity caused by areas of legal uncertainty.

If we can be of further assistance in relation to your work on the issues raised above or otherwise in relation to finalising the Draft Notice, please do not hesitate to us.

Yours faithfully,



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