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Dear Sirs,

### **Insurance Contract Law: A Joint Scoping Paper (January 2006)**

I am writing to you to provide the comments of the International Swaps and Derivatives Association (ISDA) on the issues raised by the joint scoping paper as to whether there should be a statutory definition of insurance.

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, 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. More information about ISDA is available on our website, [www.isda.org](http://www.isda.org).

ISDA considers that a review aimed at creating a statutory definition of insurance could have significant unintended consequences on the derivatives markets, in particular on the rapidly growing credit derivatives market. This market enables one market participant to transfer credit risks to another by a contract which provides for a payment or other benefit should a debtor default in payment.

At end 2005, the notional principal amount of credit derivatives outstanding was US\$17.1 trillion, after 105% and 123% growth during 2005 and 2004 respectively.<sup>1</sup> The UK has a very significant share of this market (the British Bankers' Association estimated that the UK had a

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<sup>1</sup> Source: ISDA 2005 year end market survey, available on our website.

45% of the global market in 2003<sup>2</sup>). In addition, a large part of this business is documented under English law.

As acknowledged by the Financial Services Authority in its May 2002 Discussion Paper on Cross-sector risk transfers,<sup>3</sup> the credit derivatives market is resilient and there is a high degree of confidence in the products. In 1997, ISDA obtained an opinion from Robin Potts QC which concluded that credit derivatives should not be characterised as contracts of insurance because they are structured to pay out on the occurrence of the default or other relevant event, irrespective of whether the protection buyer suffers a loss. We consider that the widespread acceptance of the so-called "Potts opinion" has meant that in practice market participants have had few concerns as to the possible impacts of boundary issues between credit derivatives and contracts of insurance.

We are concerned that any review of the boundary between contracts of insurance and other types of contract risks damaging that consensus and undermining confidence in these economically very significant products. There is a range of possible outcomes to such a review. If the outcome is seen as differing materially from the current market consensus view, it could create very considerable uncertainty and damage the market itself. Conversely, if the outcome is not seen as differing materially from the current market consensus, its value will be low.

In the circumstances, we do not consider that it would be desirable to proceed with a review in this area. However, should the Commissions decide to proceed regardless, then it will be critical to ensure that there is extensive consultation at every stage of the review in order to minimise the risks to the smooth operation of the market.

I hope that this is helpful. Please call me if you have any questions or comments.

Yours faithfully,



Richard Metcalfe  
Senior Policy Director

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<sup>2</sup> See HM Treasury, Financial Services in London: Global Opportunities and Challenges, March 2006, at para 2.13.

<sup>3</sup> DP11, available at <http://www.fsa.gov.uk/pubs/discussion/dp11.pdf>