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Sara Protheroe, Levy Manager,
Pension Protection Fund
Knollys House, 17 Addiscombe Road
Croydon CR0 6SR

by e-mail: consultation@ppf.gsi.gov.uk

Dear Ms Protheroe,

Re: The Pension Protection Levy Consultation Document December 2005

I am writing to request an urgent meeting with representatives of the Pension Protection Fund in connection with the above consultation. The members of ISDA (the International Swaps and Derivatives Association¹) have considerable interest in the issue of recognition of 'contingent assets' and in particular the proposed *lack* of recognition of credit default swaps.

We fully support the PPF Board's stated objective, namely to "encourage positive risk management by employers in relation to their pension schemes" (paragraph 2.1.5 of the Consultation Document) and agree with the notion (expressed at 2.2.2) that the risk-based levy can play an important role in encouraging the greater use of contingent assets

We believe the exclusion of credit derivatives to be misguided. While we will in due course be submitting a full written response, setting out our detailed reasoning, we believe it could be mutually beneficial to plan a meeting based on the following, necessarily brief headline points.

- Standard-form documentation very much does exist for a wide range of credit derivatives, including credit default swaps (CDS). The consultation document incorrectly asserts (p19) that this is not the case. The credit derivatives market has been in existence for over 10 years, while ISDA plays a well established and widely supported role in developing and maintaining

¹ ISDA is the trade association representing participants in the privately negotiated (or over-the-counter, 'OTC') derivatives industry. Its membership consists of more than 600 firms, including the world's largest commercial, investment and universal banks, corporations, government entities and other interested parties. ISDA was chartered in 1985 and today represents institutions from 47 countries around the world. OTC derivatives include swaps, options and forwards on interest rates, currencies, commodities, equity and credit, for all of which ISDA provides standard-form documentation. For more information, please see www.isda.org

documentation for all major forms of ‘over-the-counter’ derivatives. Much of the well publicised growth in credit derivatives can be directly attributed to the development of standard-form documentation. For a sense as to the range of credit derivatives documentation published by ISDA, please refer to: <http://www.isda.org/publications/isdacredit-deri-def-sup-comm.html>

- The new (‘Basel II’) capital framework explicitly recognises credit derivatives as a legitimate and useful means of credit risk mitigation, alongside other more traditional forms such as guarantees, letters of credit and collateral (or security over assets).
- International regulators have actively and explicitly welcomed the development of a more efficient market in credit-risk transfer in the form of credit derivatives. Please see the report of the ‘Joint Forum’ of banking, securities and insurance supervisors; entitled ‘Credit Risk Transfer’, published in March 2005 and available at: <http://www.bis.org/publ/joint13.htm>. This report concludes that “continued development of the CRT market [id est, credit derivatives] offers potential benefits in the form of more liquid and efficient markets for the transfer of credit risk.” (See page 1 of report.)
- Credit derivatives, by dint of being more liquid than other more traditional forms of credit-risk transfer, offer greater efficiency in terms of accurately pricing credit risk.
- The credit derivatives market is now significant in terms of size, growth and range of coverage of ‘reference entities’ (ie, entities on which protection may be bought). According to ISDA’s own market survey, over \$12 trillion worth of credit protection is currently afforded by credit derivatives (as of end June 2005) and this amount grew by over 100% from a year previously. ISDA publishes figures on this on its website (see: <http://www.isda.org/press/press092805.html>, or the ‘Surveys’ section of the site and specifically the ‘Market Survey’ at <http://www.isda.org/statistics/pdf/ISDA-Market-Survey-historical-data.pdf>); but for other, corroborating evidence please refer to studies published by the ratings agency Fitch or the British Bankers’ Association.

As you will appreciate, we would wish to ensure that these factors are fully reflected in the treatment of credit default swaps under the risk-based levy.

We will follow up regarding the possibility of a meeting in early January but please do not hesitate to contact us in the meantime if you wish to discuss any of the above.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'R. Metcalfe', written over a vertical red line.

Richard Metcalfe
Senior Policy Director