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15 December 2005

Dr Ekaterina Sidorova
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Mr Oleg Ivanov
Secretary, Expert Council of the State Duma Committee on Credit Organizations and Financial
Markets
The Federal Assembly of Russia
1 Okhotny Ryad Street
Moscow 103265, Russia

By e-mail

Dear Dr Sidorova,
Dear Mr Ivanov.

**Memorandum of Working Group on Legal Matters of the ARB Committee for Standards
and Uniform Rights of the Forward Market (“ARB Memorandum”)**

The International Swaps and Derivatives Association, Inc. (“ISDA”) respectfully presents this letter to the Association of Russian Banks’ Working Group on Legal Matters pursuant to the kind invitation extended to ISDA jointly by the Russian State Duma’s Committee on Credit Organizations and Financial Markets and the Association of Russian Banks. Pursuant to this invitation ISDA had the pleasure to meet the Expert Council on 23 September 2005. ISDA expresses its gratitude to have been given the opportunity for discussion with Duma experts for the third time in as many years. We refer to the English translation of the above-mentioned Memorandum which was forwarded to us pursuant to the meeting. We appreciate the opportunity to provide comments on Memorandum from the perspective of the global derivatives markets. At the September meeting we indicated our strong support for the work that is being undertaken by

the Russian State Duma and the Association of Russian Banks and we stand ready to provide further more detailed technical comments as the work of the Expert Council progresses.

ISDA is the global trade association representing leading participants in the privately negotiated derivatives industry. ISDA was chartered in 1985, and today has more than 670 member institutions from 47 countries, including Russia. These members include most of the world's major financial institutions that deal in privately negotiated derivatives, as well as many corporations, governmental entities and other end-users that use over-the-counter derivatives to manage efficiently the financial market risks inherent in our business activities. ISDA documentation is the standard for OTC derivatives transactions globally, as also referred to in the aforementioned ARB Memorandum. A current list of ISDA's members, as well as other information about ISDA and its activities, is available on our website at www.isda.org.

We express our full support for the endeavours currently undertaken by Russian financial market regulators and ministries, the Russian Central Bank, the Russian State Duma as well as the Association of Russian Banks to clarify the legal framework for OTC derivatives transactions with Russian counterparties. As mentioned in previous letters, we defer completely to national legal experts in Russia on the appropriateness of any proposed legislation in the general scheme of Russian financial markets legislation and its interaction with other substantive areas of Russian law. Our comments are exclusively from an international financial market perspective, and we hope that you will find them helpful as respectful suggestions for your consideration.

1. Chapter 5 of the ARB Memorandum addresses the question of the enforceability of claims resulting from OTC derivatives transactions. As outlined by ISDA from the outset of the discussions with Duma experts, the appropriate handling of the gaming defence is crucial to the development of a derivatives market. The ISDA presentation given at the 23 September meeting provided a report on the legislative and regulatory approach taken by Germany as an example of a country with a Roman-Germanic legal tradition. We understand that, in the meantime, a draft proposal to amend the Russian Civil Code in order to exempt derivatives transactions from gambling provisions has been submitted. However, chapter 5 of the ARB Memorandum seems to suggest that derivatives transactions should only be enforceable if at least one counterparty is a Russian bank. In order to achieve stability of the financial markets all counterparties entering into derivatives transactions with banks and other entities should benefit from the enforceability of such transactions irrespective of the fact of being licenced under Russian banking laws.
2. A large number of counterparties to derivatives transactions worldwide as well as in Russia come from the corporate sector. For example, many financial institutions enter into derivatives transactions with their corporate clients. Also, by restricting the scope of eligible counterparties derivatives transactions between Russian non-financial institutions and a foreign counterparty would remain unenforceable. The same applies to derivatives transactions with the Russian Central Bank or municipal entities etc. If any restriction of the scope of eligible counterparties needs to be imposed at all, one could exclude any derivatives transaction between natural persons as the only counterparties to this

transaction. In other words, any transactions between any legal person, foreign or domestic, and any bank or financial institution, foreign or domestic, or an entity under public law, be it domestic, foreign or international, should not be regarded as a wagering transaction. By this way, special purpose vehicles, non-financial institutions as well as entities under public international law would also be eligible counterparties under Russian law. These types of entities constitute a significant number of participants in global financial markets.

3. The introduction of close-out netting legislation amending existing insolvency legislation is another crucial factor to promote a stable derivatives market, as outlined in previous letters and statements by ISDA (please see attached). Hence it is very important to include all types of derivatives transactions in any such legislation. Chapter 4 of the ARB Memorandum provides a definition of “forward agreement”. We suggest to use the term “derivative transaction” instead and define it as a forward transaction, swap transaction or option transaction whose price is directly or indirectly dependent upon the price of securities, money market instruments, currencies, interest rates, credit risk, precious metals, commodities (including electricity, weather statistics, freight, transmission capacities, emissions allowances), economic statistical data or any other parameter, for which a market has been or will be established in the future. This definition ensures that innovations and developments in the global derivatives markets would be taken into account by domestic legislation. Were one to choose the term “qualified financial contract” the scope of transactions eligible for netting could be extended even beyond OTC derivatives transactions. Also, it is ensured that exchange-traded futures and options are subject to a different regime governed by the rules of the relevant exchange.
4. In the context of the scope of counterparties eligible to derivatives agreements and transactions eligible for the benefits of close-out netting the question of financial collateral arrangements becomes relevant. It needs to be highlighted that title transfer collateral arrangements as opposed to security interest are the predominant form of financial collateral arrangement in European markets. The European Directive on Financial Collateral Arrangements ensures equal treatment of both forms. Also, it does away with several formal requirements that hinder efficiency when it comes to realization of collateral as well as the creation and perfection of security.
5. The concluding paragraph of the ARB Memorandum aims at, *inter alia*, achieving clarification of prudential ratios for credit institutions includes wording reminiscent of provisions adopted by certain regulators when it came to transposing the first Basel Capital Accord. The New Basel Capital Accord includes rules that are less strict than some of the proposals contained in the ARB Memorandum. For example, the Basel Accords permit the use of both external as well as in-house legal opinions at the time of the relevant transaction. Also, “master agreements” as documentation recommended for purposes of capital relief may take the form of any type of standard framework agreement in place between two counterparties. Such master agreements need not be authorized by any national authorities or trade associations.

6. Furthermore, please allow us a few comments on several issues addressed throughout the ARB Memorandum. Chapter 1 addresses automatic early termination, a legal concept that requires special attention in certain jurisdictions and raises many issues. The concept is usually used to avoid any conflict with an otherwise applicable insolvency regime. Hence automatic early termination is not to be regarded an element of any efficient close-out netting legislation. This is achieved by the recognition of master agreements following the single agreement concept and by recognizing termination and close-out of derivatives transactions upon and after bankruptcy.
7. Chapter 4.B. entitled termination of the agreement refers repeatedly to “terminations” of a master agreement. One major characteristic of master agreements is the fact that only transactions under a master agreement get terminated, not the master agreement itself. Therefore, it is suggested to use the term “transaction” instead of “individual agreement”.
8. Credit derivative transactions mentioned in the penultimate paragraph of chapter 4 of the ARB Memorandum should be defined as “including credit default swaps, total return swaps”.
9. As a general matter it seems desirable to have domestic documentation drafted in a way that is as consistent as possible with standard documentation used in the global markets. This decreases basis risk across contracts and enhances the smooth functioning of the markets. The diagram used in chapter 3 resembles a previous structure of domestic documentation developed for the German market. In the meantime, several modifications and amendments to this architecture have taken place and continue to be undertaken. Several new product annexes have been added in the meantime. For a similar structure regarding global cross-border documentation please refer to the architecture of ISDA documentation which is being updated and amended regularly to reflect the latest status of the financial markets.

We hope that you find these comments helpful. We remain at your disposal for further clarifications. For your information, please find attached a submission made in November 2004 to the Head of the Federal Service for the Financial Markets. Please keep us up-to-date regarding any revised versions of the memorandum and draft bills in this context. Should you require any further information, please do not hesitate to contact Peter Werner in London on +44 20 7330 3550 / pwerner@isda.org.

Yours faithfully,



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