



I S M A

INTERNATIONAL SECURITIES MARKET ASSOCIATION

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Chief Executive and Secretary General

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JLL/zk

By e-mail

The Financial System and Major Operational Disruption
FSM Team
Room 4/16
HM Treasury
1 Horse Guards Rd
GB-London SW1A 2HQ

The Financial System and Major Operational Disruption

Dear Sirs

The International Securities Market Association (ISMA) welcomes this opportunity to comment on the consultation paper on this important and topical subject.

ISMA has a unique status in the UK as both an International Securities Self-regulating Organisation (ISSRO) and Designated Investment Exchange (DIE). In Switzerland, the Swiss Federal Banking Commission (the SFBC) has recognized ISMA as an institution similar to an exchange ("börsenähnliche Einrichtung") under the Federal Act on Stock Exchanges and Securities Trading (SESTA) which came into force in February 1997/January 1998. Of its global membership of 474 in 46 jurisdictions (as at April 25, 2003) 86 are based in the UK.

ISMA's principal mission is to build consensus among its members and others on ways to ensure the smooth and efficient operation of the international, cross-border securities market. It has therefore viewed with great concern the potential for international terrorists to cause major damage to this market.

As a matter of policy, ISMA generally does not respond to domestic regulatory initiatives. In this case, however, ISMA considers it has a responsibility to comment on behalf of those of its UK members who will be directly affected by the legislative and regulatory changes which may emerge from HMTreasury's further consideration of the issues raised in this important paper in conjunction with the views expressed by respondents.

Furthermore, ISMA's interest arises from the fact that the UK is the jurisdiction in which the greatest proportion of global trading in international debt and debt related securities takes place and is the location of choice for the overwhelming majority of banks and investment banks which are the pre-eminent source of liquidity for globally located investors in these securities.

We welcome therefore this initiative and the measured and thoughtful approach HMT has adopted in discussing these vitally important issues. In particular ISMA values HMT's recognition that, as stated in the paper, *'the main responsibility for responding to major operational disruption's effects on the financial system can only realistically rest with the private sector.'* We also acknowledge that there may be a role for the authorities in buttressing a market led approach in these uncertain and dangerous times.

In this regard, the market for international securities over which ISMA exercises self-regulatory authority raises many issues. As well as being a global market it is very large, diverse and, in terms of trading at least, operates largely without any formal market infrastructure, whether in the UK or beyond. Last year new issues in excess of 1.7 trillion euro were sold to investors, and while accurate figures for secondary market trading are not available, turnover is thought to be in the region of 100 trillion euro. Although the securities traded in this market are issued and settled in a variety of currencies, the vast majority do so in euro and US dollars. The euro-sterling sector is also significant. Trading takes place almost entirely outside the framework of formal market infrastructure and although alternative trading systems (described in the paper as quasi-infrastructure) have made some inroads, the majority of business still consists of traditional bilateral transactions undertaken directly between counterparties (albeit often intermediated by a broker on a name give-up basis).

Clearing and settlement also takes place globally, although principally through Euroclear in Brussels and Clearstream Banking in Luxembourg. Very little clears or settles in the UK. On a daily basis we estimate that securities worth more than 300 billion euro are traded and securities worth between 300 to 400 billion euro of await settlement (T+3). Counterparties may be based in fifty or more jurisdictions, securities may be located in several jurisdictions and payment may not take place in the same jurisdiction as the change of ownership (eg payment for dollar bonds may ultimately take place in New York while the bonds themselves remain in custody in Brussels). The legal qualification of the associated contracts may not be straightforward either. Perhaps half, or even more of the daily traded volume consists of repurchase transactions where the settlement of the collateral may involve other parties and other laws. There must therefore be a question as to whether, *in the case of the international securities market*, one jurisdiction, acting in isolation, can realistically achieve its policy goals.

At the very least we would argue that, on our understanding of the likely timetable for the Civil Contingencies Bill, its schedule is most unlikely to be sufficient to permit an adequate analysis to be completed of the many

complex issues raised in the paper and for a consensus to emerge as between the various national and supranational authorities and market participants in the world's most important financial centres on those measures which would be most effective in dealing with a major operational disruption to the international financial system. In the absence of such detailed work, we fear that there is a very real risk that greater rather than less uncertainty will be created to the detriment of the market globally.

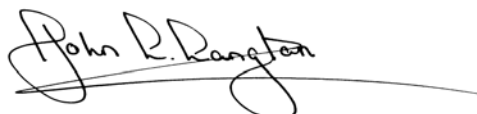
ISMA would be pleased to be part of such a process to which it would bring its extensive experience of analysing and resolving cross-border legal issues gained, in areas such as its development (in association with The Bond Market Association of the US) of a Global Master Repurchase Agreement.

Given the structure of the international securities market, ISMA has chosen not to discuss the possible impact of the options discussed in the paper as regards formal or indeed quasi- infrastructure on which we understand that HMT has received a number of detailed submissions, other than to note that a power to give directions to a UK RIE or RCH already exists, subject to a duty to consult, in section 166 of the Companies Act 1989, in the context of such a body's default rules. Although the conditions of its use may need minor modification, we wonder whether this provision might already be sufficient to meet many of HMT's purposes.

Finally, we are very pleased that HMT has rejected the introduction of a power of prohibition (4.26) and that any power of direction would not be structured so as to prohibit off-exchange transactions (4.27). It must be right that two willing counterparties should not be prevented from concluding bilateral transactions in financial securities even when external circumstances may be very difficult. Indeed, the market in the immediate aftermath of 9/11 demonstrated that this ability, exercised responsibly, can play a major part in restoring normality to the global financial market.

My colleagues or I would be happy to discuss any of these and related issues further with officials.

Yours sincerely

A handwritten signature in black ink, appearing to read "John L. Langton". The signature is written in a cursive style with a long horizontal flourish extending to the right.

John L. Langton

cc: Mr. Richard Britton, ISMA Consultant on International Regulatory Matters
Mr. Thomas Hunziker, General Counsel, ISMA, Zurich