
A RETROSPECTIVE OF ISDA'S ACTIVITIES IN 2002

ISDA[®]

INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

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January 27, 2003

Dear ISDA Member:

With the support of our member firms, ISDA continued its work on behalf of the derivatives and risk management industry in 2002. A number of important projects were completed, new initiatives were launched, and our ongoing efforts in a range of areas -- documentation, netting, public policy, collateral, risk management and technology -- continued.

One of the key signs of the Association's effectiveness is the continuing increase in membership we enjoyed in 2002. Eighty-four new members joined the Association this past year, bringing our total membership to nearly 600 firms, spanning 46 countries on six continents.

We ring in the New Year keenly aware that the economic recession continues to challenge our markets. With this in mind, we have maintained existing dues levels and remain focused on further adding value to our members as we continue to actively fulfill our mission to reduce risk and promote practices conducive to the efficient conduct of our business.

Documentation

2002 was a busy year for ISDA in the documentation area. Our biggest achievement was undoubtedly the highly anticipated publication of the *2002 ISDA Master Agreement*. While maintaining the core elements of the original, the new Master incorporates a number of market-driven enhancements and represents a milestone achievement in the documentation of a variety of products.

2002 also saw the publication of the *2002 ISDA Equity Derivatives Definitions*, which expand product coverage and offer more tailored provisions for counterparties. In addition, we expect publication of the *2002 ISDA Credit Derivatives Definitions* in the coming weeks. (Please see the Credit Derivatives section of this letter for further details).

In order to educate our members on this trilogy of new documents, we have scheduled *Understanding the New ISDA Documentation* conferences in several cities across the globe. Please visit the ISDA web site for further information or to register.

2002 also saw publication of the *2002 Energy Agreement Bridge* and the *Novation Agreement and User's Guide*. Based on the *2001 ISDA Cross-Agreement Bridge*, the Energy Bridge is intended to provide parties to the *1992 ISDA Master Agreement* with a means to achieve a form of cross-product netting.

Credit Derivatives

Credit derivatives use continued to rise in 2002 and remains the fastest growing segment in the OTC derivatives industry. Our *Mid-Year Market Survey* showed a 44 percent growth in these instruments since year-end 2001, with outstandings growing 35 percent to \$1.6 trillion.

Given the significant growth of the credit derivatives market, there has been much anticipation surrounding the publication of the *2002 ISDA Credit Derivatives Definitions*. Members will be happy to know that we expect to publish the Definitions at the end of January 2003. These Definitions will significantly enhance documentation of credit default swaps, including amendments to incorporate the three Supplements published in 2001, new settlement provisions and new guarantee and Sovereign credit default swap provisions.

Collateral

Collateral use in privately negotiated derivatives transactions and related margined activities (such as repo and structured products) continued to grow, as our 2002 Margin Survey highlighted. The survey results showed the amount of collateral in circulation exceeding \$437 billion, a 75 percent increase over the \$250 billion reported in the 2001 survey. The results demonstrate the commitment of derivatives dealers and end-users to effectively manage counterparty exposure.

ISDA remained active on the collateral law reform front, working closely with the Hague Conference on Private International Law to draft a convention on indirectly held securities. The convention was adopted by member states in December 2002 and we were pleased to see that several provisions we lobbied for were included in the final version. ISDA's efforts continued as the European Collateral Directive moved toward implementation throughout Europe.

We continued to expand the number of jurisdictions where we obtain netting and collateral opinions, adding collateral opinions for the British Virgin Islands and Norway and netting opinions for the British Virgin Islands, Hungary and Turkey, bringing our total number of opinions to 39. Collateral opinions for Scotland and South Africa are currently in draft form.

Public Policy

In 2002, we maintained our high profile in the U.S. regulatory arena, where we remained active in opposing additional regulation of OTC derivatives in the aftermath of the Enron collapse.

We were very vocal in our opposition to efforts to reverse legal certainty provisions adopted as part of the Commodity Futures Modernization Act of 2000. We circulated an industry-wide letter signed by over 50 entities protesting additional regulation. At our 17th Annual General Meeting in Berlin, we issued a report examining the failure of Enron: "Enron: Corporate Failure, Market Success," which demonstrated that derivatives were not a factor in the firm's collapse. In our testimony before the U.S. Senate Committee on Agriculture, Nutrition and Forestry on July 10, we further cautioned that proposals to alter the CFMA would defeat the underlying policy objective of legal certainty for OTC derivatives. As we transition into 2003, we remain committed to lobbying against unwarranted and detrimental regulation of OTC derivatives.

ISDA also continued to urge passage of bankruptcy reform legislation in the U.S., which contains provisions designed to strengthen and clarify the enforceability of early termination and close-out netting provisions in U.S. insolvency proceedings. Together with other industry groups, we spearheaded the effort to see the legislation enacted in 2001, and were disappointed when the U.S. Congress failed to pass the legislation for the fifth year in a row. Since the netting provisions will undoubtedly reduce systemic

risk to the financial markets, we will continue to work toward passage of this important legislation in 2003.

ISDA also remained active in the European regulatory arena in 2002. The European Commission has adopted a proposal to revise the 1993 Investment Services Directive, a process that we have been actively involved in for two years. As the legislative process moves forward, we will continue to monitor the ISDA's progress and respond as necessary.

In 2002 we also remained involved in the Commission's Directive on Market Abuse, which would replace the existing Insider Dealing Directive and introduce a new regime relating to market manipulation. We led a group of trade associations in drafting amendments to the Directive and were pleased to see a number of our concerns addressed. We believe further work on the Directive is necessary and we will continue to provide guidance as needed.

Risk Management

A fundamental part of ISDA's mission remains promoting sound risk management practices. To that end, ISDA, together with the International Association of Credit Portfolio Managers and the Risk Management Association, jointly sponsored the 2002 Survey of Credit Portfolio Management Practices. Based on responses from 41 institutions worldwide, the survey showed substantial development of portfolio credit risk modeling and management.

We also continued our extensive work with banking regulators, the EU Commission and the Basel Committee on Banking Supervision to promote the adoption of risk sensitive capital adequacy standards. We maintained our active role in the process to reform the current capital accord by providing detailed responses to proposals by the Basel Committee. The Committee is expected to publish the third and final consultative paper on the accord in the spring, which we look forward to reviewing.

Technology

The integration of FpML into ISDA's organizational structure was completed in January 2002. This action was the final step in the integration process initiated in 2001 to combine ISDA's organizational strengths with FpML's technology base for sharing information on, and dealing in, OTC derivatives.

In 2002, energy and equity derivatives joined interest rate, FX and credit derivatives as part of the FpML standard, which will eventually cover all categories of privately negotiated derivatives. During the year, we issued calls for participation for FpML energy, validation, messaging and credit derivatives working groups to further the development of FpML. In order to educate our members on the processing efficiency FpML offers, ISDA held its first ever FpML conferences in New York and London.

In another effort to increase the efficiency of our members through technology, we launched *netalytics*, an online netting analysis tool that enables members to determine quickly and easily whether a particular transaction is eligible for netting in any of the jurisdictions from which ISDA has obtained netting opinions. In doing so, *netalytics* helps firms save time and money and reduce legal and credit risk.

Operations

We released our 2002 Operations Benchmarking Survey: *Over-The-Counter Derivatives Operations Issues*, which for the first time, provided comparisons with the results of the previous year's survey, while also adding data relating to credit and equity derivatives processing. Based on responses from 65 member firms around the world, the survey reported an increase in automation since the 2001 survey, especially for forward rate agreements and vanilla swaps.

Our N2 Working Group, established in 2001 to address issues arising from the U.K. Financial Services Authority's formal assumption of powers, has continued to work closely with the U.K. Investment Banking Association to highlight areas of concern and present a coordinated industry position on appropriate business standards.

And we established four new working groups under our Operations Committee in 2002 – Metrics, Process, Credit Derivatives and Interest Rate Derivatives.

Emerging Markets

In 2002, much of our focus in Central & Eastern Europe involved our lobbying efforts for the enactment of netting legislation in Poland, Slovakia, and the Czech Republic. In addition, we hosted an educational seminar in Budapest, Hungary in conjunction with the EU Commission Directorate-General Enlargement's Technical Assistance Information Exchange Office (TAIEX).

We continued to support the enactment of netting legislation in Latin America, particularly in Argentina and Brazil. In addition, we established a local credit derivatives working group to follow up on issues arising from the Brazilian Central Bank's regulations relating to credit derivatives dealing, which became effective in April.

Asia-Pacific

We were very active in Asia-Pacific public policy in 2002, maintaining dialogues with the Hong Kong Bills Committee, the Ministry of Finance and Economics in South Korea, the Monetary Authority of Singapore and the People's Bank of China on various issues affecting OTC derivatives activities throughout the region.

We launched an Asia-Pacific Loss Given Default Study with the establishment of a steering committee consisting of representative banks from Japan, Malaysia, Singapore and Thailand. Steering committee members reviewed the data sets and definitions used in the existing European Loss Given Default Study for their relevance to the region's markets in general and members' own geographic areas in particular.

Our 2002 Member Update in Hong Kong was well attended, as were several other events held in the region during the year. These included seminars and conferences for members in Kuala Lumpur, Singapore, Bangkok, Hong Kong, Sydney and Taipei.

Japan

In 2002, the Japan Credit Derivatives Committee was very active in the process to update the 1999 ISDA Credit Derivatives Definitions. In addition, following months of discussion among members and with regulators, the Committee agreed to drop Obligation Acceleration and Repudiation/Moratorium from the list of credit events to be covered by standard transactions for Japanese corporations.

The Japan Equity Derivatives Committee also kept busy during the year reviewing and providing comments to drafts of the 2002 Equity Derivatives Definitions. So too did the Japan Weather Derivatives Committee, which met regularly and provided input into our global efforts in this area of the business.

Conferences

Attendance at ISDA conferences continued to be impressive in 2002. We enjoyed high attendance at our Member Updates in New York, London and Hong Kong, as well as at our 2002 Annual General Meeting in Berlin, Germany, which was attended by over 700 members. We hope that we will see many of the same faces, as well as new ones, at our 2003 AGM in Tokyo, Japan April 9-10.

Looking Ahead

Each year brings changes, some of them affecting the composition of our Board of Directors. At the 2002 AGM in Berlin, we welcomed six new Board members. They are Jonathan Chenevix-Trench of Morgan Stanley, Masahiro Hosomi of the Bank of Tokyo-Mitsubishi, Dixit Joshi of Credit Suisse First Boston, Robert Mancini of Goldman Sachs, Riccardo Rebonato of the Royal Bank of Scotland, and Kenneth Tremain of Citigroup/Salomon Smith Barney. During the year, Mark Beeston of Deutsche Bank resigned and was replaced by Michele Faissiola, also of Deutsche Bank. Azam Mistry also resigned after leaving HSBC. At the forthcoming AGM in Tokyo, Teruo Tanaka of Mizuho Corporate Bank, Ltd. will be completing his service on the Board. We thank all of these individuals for their dedication to the Association over the years.

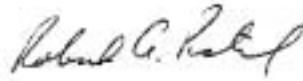
With the support of our member firms, ISDA continued to effectively address the issues facing the industry in 2002. As we welcome 2003, we look forward to working with our members to continue to fulfill our mission of encouraging the prudent and efficient development of the OTC derivatives business and the development and maintenance of sound risk management practices.

We thank you for your membership and support and extend to you our best wishes for 2003.

Sincerely,



Keith Bailey
Chairman



Robert G. Pickel
Executive Director and CEO

**INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.
BOARD OF DIRECTORS DURING FIRST QUARTER OF 2003**

Officers

Keith A. Bailey

Chairman & Managing Director
Merrill Lynch Capital Services, Inc.

Henning Bruttel, Vice-Chairman
Senior Manager
Head of Foreign Exchange/Commodities
Dresdner Bank AG

Douglas Bongartz-Renaud, Secretary
Global Head of Foreign Exchange Options,
Global Financial Markets Division,
ABN Amro Bank N.V.

Diane Genova, Treasurer
Managing Director & Associate
General Counsel
J.P. Morgan Chase & Company

Robert Pickel
Executive Director & Chief Executive Officer
ISDA

Directors

Kaushik Amin
Global Co-Head Interest Rate Products
Lehman Brothers Inc.

Michael Bass
Global Head,
Interest Rate Derivatives
Standard Chartered Bank

Jonathan Chenevix-Trench
Global Head of Interest Rates and Foreign Exchange,
Head of Fixed Income, Europe
Morgan Stanley

Jerry del Missier
Managing Director
Barclays Capital

Michele Faissola
Global Head of OTC Derivatives and
Commodities Trading
Deutsche Bank

Tim Fredrickson
Global Head of Fixed Income Derivatives &
Government Bonds
UBS Warburg

Jose Manuel Hernandez-Beneyto
Director General Adjunto
Banco Santander

Masahiro Hosomi
Senior Manager, Derivatives & Structured Products
Division
The Bank of Tokyo-Mitsubishi, Ltd.

Frédéric Janbon
Global Head of Interest Rates Group
BNP Paribas

Dixit Joshi
International Head of Index Arbitrage,
Statistical and Program Trading
Credit Suisse First Boston Europe, Ltd.

Robert Mancini
Managing Director, Deputy General Counsel, Fixed
Income, Currency & Commodities Division
Goldman, Sachs & Co

Jonathan Moulds
Head of Global Rates
Bank of America

Ernest Patrikis
Senior Vice President & General Counsel
American International Group, Inc.

Riccardo Rebonato
Head of Group Market Risk
Royal Bank of Scotland

Luciano Steve
Head of Fixed Income
BCI Intesa

Teruo Tanaka
Senior Vice President, Legal Division
Mizuho Corporate Bank, Ltd.

Kenneth Tremain
Managing Director and Head of North American
Fixed Income Derivative Trading
Citigroup/Salomon Smith Barney

ISDA COMMITTEE ACTIVITIES

Over the course of the past year, the International Swaps and Derivatives Association has continued its drive to ensure a sound legal and documentation framework for the trading of privately negotiated derivatives across the globe. In that same period, the Association's semi-annual Market Survey shows that total notional outstanding volumes in plain vanilla interest rate and currency products rose to \$99.83 trillion; a rate of growth of just over 20% in the six months to year-end 2002.

According to ISDA's mission statement, the Association's primary purpose is to encourage the prudent and efficient development of the privately negotiated derivatives business by promoting practices conducive to the efficient conduct of the business, including the development and maintenance of derivatives documentation. In the latter respect in particular, ISDA had a banner year, publishing not only the revised 2002 Master Agreement, the industry framework document, but also revised Definitions for two of the most significant product areas: Equity Derivatives and Credit Derivatives. Notional volumes outstanding in these products grew to \$2.45 trillion and \$2.15 trillion respectively by year-end 2002; for the credit derivatives market, a 37.4% increase since mid-year alone.

Another part of ISDA's mandate is to educate members and non-members alike on issues affecting them in their business in the privately negotiated derivatives markets. The Association began in the first quarter of 2003, a series of documentation 'road shows' across the six continents of its membership in the use of its new slate of documentation, adding to an already extensive schedule of conferences, seminars and member updates. ISDA's roster of educational events addresses not only ISDA's work in legal and documentation issues, but in legislative and regulatory issues, tax and accounting, operational and technological issues, as they touch the practice of OTC derivatives business. These conferences also include the Association's Annual General Meeting, the industry's landmark event, held in 2002 in Berlin, and scheduled in 2003 to take place in Tokyo.

Promoting the development of sound risk management practices is an important part of ISDA's mission and over the course of the past year the Association's risk management effort has focused its attentions in large part on proposed changes to the Basel Accord. ISDA has addressed in particular the treatment of credit risk, securitization and operational risk. ISDA has similarly been focusing on the European Union's third Capital Adequacy Directive (CAD III) over the past year. Through a series of seminars on risk management issues, ISDA also highlights bellwether trends in this area of its membership, with high level speakers presenting free to members in London and New York.

2002 was also the year ISDA formally absorbed FpML, the organization responsible for the development of Financial Products Markup Language, technology that further facilitates the secure undertaking of the OTC business. Fostering high standards of commercial conduct is an explicit goal of ISDA's, which is also undertaken through its product-specific committees, including credit and equity derivatives, where members aim to forge consensus on best practice for their businesses. In ISDA's regulatory, tax and accounting activities, these discussions play out to a significant degree with supervisory and regulatory authorities, as ISDA works to advance international public awareness and understanding of the business and to represent the common interest of its members.

These are only some of ISDA's aims and achievements over the past year. The following pages set forth the details of each committee's activities. We welcome your comments on ISDA's activities and on this Retrospective Review.

Accounting

Europe

A significant part of the focus of the European Accounting Committee for 2002 was on the International Financial Reporting Standards (IFRS) drawn up by the International Accounting Standards Board (IASB). These standards will become mandatory for all European listed companies in the European Union by 2005. ISDA was represented at roundtable discussions with the IASB in March 2003 on improvements to the key financial instruments standards, IAS 32 and 39. The Board focused on four topics: the distinction between debt and equity recognition (including derivatives on own shares); derecognition; derivatives and hedge accounting; and impairment. ISDA's work on valuation continues in addressing the fair valuation hierarchy and its impact on a range of derivative products.

Following its October comment letter to the IASB (available at www.isda.org), the Committee has continued its work on the impact of fair valuation on the derivatives markets and is currently coordinating with ISDA's North American committee on a more detailed response in time for a separate meeting with the IASB.

Other projects underway include the IFRS Exposure Draft on "Deposit-Taking, Lending, and Securities Activities: Disclosure and Presentation" due in the second quarter of 2003. The committee will also discuss the extensive disclosure requirements that will be set out in Pillar III of the New Basel Accord. A draft of these requirements will be set out in the Basel Committee's Third Consultative Paper (CP3) due out in early summer. The committee also anticipates furthering its work in Brussels through the continued representation of ISDA on the Forum Group on Financial Reporting and through interaction with the European Financial Reporting Advisory Group (EFRAG).

North America

In early 2002, ISDA's North American Accounting Committee coordinated a number of accounting projects through joint working groups with the Bond Market Association (BMA) and the Securities Industry Association (SIA). The projects focused on fair value, Derivatives Implementation Group (DIG) issues relating to accounting for beneficial interests, and any new disclosure or accounting proposals arising as a result of Enron's financial crisis including new SPE (special purpose entities) guidance. ISDA's North Accounting Committee was also active in projects relating to FASB's efforts on Liabilities vs. Equity, guidance on credit derivatives and guarantees and energy derivatives trading. The committee also coordinated with the European committee on comments submitted to the International Accounting Standards Board's relating to proposed amendments to IAS 32 and 39

The SPE Consolidation Working Group reached out to FASB to address issues relating to the Consolidation Project. The working group encouraged FASB to assure that the guidance is workable and is established on a solid understanding of the markets, products and impacts. The Joint Working Group also developed an educational paper on SPE's and the securitization markets.

Editor's Note

In previous years, this annual Retrospective of ISDA Activities has tracked the Association's work from the beginning of the calendar year to the end. Because this document is published to coincide with ISDA's Annual General Meeting in April of each year, the Association has determined henceforward to publish the Retrospective in accordance with the Association's year running from April 1 to March 31. Since this is the first year in which ISDA will publish in this manner, this year's document covers the period from January 1, 2002 to March 31, 2003.

The Fair Value Working Group successfully completed a comprehensive paper entitled “Explanation and Benefits of Fair Value Accounting” explaining that many financial instruments are measured and reported at fair value and that firms have successfully reported at fair value due to the use of accurate models used in these valuations that are reasonable and reflect underlying market conditions.

The D2 Working Group completed work in the summer on comments to FASB regarding beneficial interests and financial guarantees. The July 1 comment letter filed by the Joint Industry Working Group (JIWG), commented that the proposed D2 model for applying Statement 133 to beneficial interests will add a significant layer of complexity to an already complex standard without readily apparent improvements to current financial reporting. ISDA also filed a comment letter to FASB supporting the changes made to the definition of a financial guarantee and recommending deletion of DIG Issue C7 since the new definition of a financial guarantee no longer requires the occurrence of a loss to qualify for financial guarantee scope exclusion.

In July, ISDA issued comments on FASB’s *Proposed Statement of Financial Accounting Standards, Amendment of Statement 133 on Derivative Instruments and Hedging Activities* addressing financial guarantees. ISDA’s comments addressed the financial guarantee scope exception and expressed concern with the relationship between revised guidance and DIG Issue C7. Issue C7 is inconsistent with the new definition since it requires that the guarantee contract explicitly state that the guaranteed party has exposure to and the occurrence of a loss in order to qualify for the scope exception. The new definition of a financial guarantee, however, does not require the occurrence of a loss.

In late October, FASB's Emerging Issues Task Force (EITF) voted to rescind Issue No. 98-10 "Accounting for Contracts Involved in Energy Trading and Risk Management Activities." The action raised a number of valuation issues relating to energy derivatives. Only energy contracts that meet the definition of derivative under FAS 133 will be able to be carried at fair value. Energy contracts that do not meet the definition of derivative must be accounted for on an accrual (recorded only as the contracts are settled) basis. This extends to broker/dealers that account for financial instruments at fair value. The EITF also decided that all derivative trading gains and losses (realized and unrealized) on energy derivatives must be reported net in the income statement. Prior guidance allowed gains and losses to be shown as either gross or net in the income statement. This guidance affects all contracts existing as of October 25 and all contracts entered into after October 25. ISDA issued a comment letter to the EITF on December 31 outlining concerns relating to EITF Issue No. 02-3. Specifically, ISDA raised the concern that FASB staff inappropriately broadened the scope of Issue No. 02-3 beyond energy trading to include all derivative transactions and the appropriateness of recognizing an unrealized gain or loss at the inception of a derivative transaction absent any discussion with the Task Force and solely through the October meeting minutes process.

Asia-Pacific

In 2002, ISDA’s Asia-Pacific Office continued to focus on supporting members based in the region, encouraging active participation in ISDA’s committees, ensuring a dialogue with relevant regulatory bodies in jurisdictions, such as Hong Kong, India, Malaysia, People’s Republic of China, South Korea, Singapore, Taiwan and Thailand, and conducting seminars and conferences for members on topical issues.

Outline Of Asia-Pacific Committee Structure

Regional Committees were initially established in the mid-1990's. From the outset, the region operated as two groups, one based in Singapore and the other in Hong Kong. Initially, the Committees were solely comprised of derivatives industry business leaders in the region; this group is now run as the Steering Committee. A Legal and Regulatory Subcommittee operates under the aegis of the full committee. Since the opening of the Asia-Pacific Office in October 2000 a looser group of collateral professionals has been consolidated to form the Asia-Pacific Collateral Committee, which operates as a sub group to the global Collateral Committee. The various ISDA Committees have met regularly throughout 2002 and members have benefited from being able to participate directly in discussions on regional and global matters as well as receive information on ISDA's activities worldwide.

Hong Kong

In February, ISDA submitted comments on the Companies (Corporate Rescue) Bill. Amongst other issues, the draft Bill aims to carve out certain types of derivative transactions but the list of transactions currently does not reflect current market practice and also does not provide sufficient flexibility for future developments. ISDA continues to monitor developments of the Companies (Corporate Rescue) Bill and conduct dialogues with relevant Hong Kong authorities.

In response to member interest, Credit and Equity Derivative Subcommittees were set up to provide a forum for regionally based members to discuss global market practice and documentation developments. In June 2002, ISDA launched the HKD ISDAFIX rate with the support of 16 member institutions providing quotes published daily on Reuters. In December, ISDA held a conference on "Risk Management and Credit Derivatives" for market practitioners.

India

In March 2002, ISDA visited various regulators in India to discuss issues of mutual interest relating to enforceability of netting and product coverage. ISDA, with the support of FIMMDA, provided a seminar for interested market participants on the understanding of the ISDA Master Agreement.

In September 2002, ISDA conducted discussions relating to proposed Swap Market Protocol for members based in India, initiated by a number of locally active member institutions. Since then the Reserve Bank of India set up a working group to examine the development of rupee derivatives markets and ISDA continues to support the efforts relating to the enhancement of legal certainty.

Malaysia

In May 2002, ISDA held a seminar in Kuala Lumpur for risk management practitioners on ISDA's work on reviewing the Basle Capital Accord.

People's Republic of China

ISDA conducted dialogues with the People's Bank of China (PBC) and reviewed the proposed "Administrative Measures on Financial Institutions Engaging in Derivatives Transactions", including the discussion draft and explanatory notes on "Guidelines on Market Risk Management for Commercial Banks".

ISDA also continued the dialogue with the State Administration of Foreign Exchange (SAFE) on the need to register collateral. Dialogue with China Securities Regulatory Commission (CSRC) supervision of OTC Commodity Derivatives. In September 2002, ISDA hosted a seminar for the China Securities Regulatory Commission (CSRC) on OTC Commodities Markets.

Singapore

In March 2002, ISDA hosted a conference on Documenting Credit and Equity Derivatives. In May, ISDA conducted a seminar for risk management practitioners on ISDA's work on reviewing the Basle Capital Accord and in October it was Singapore's turn to host the Annual Update which focused on regional developments as well as the upcoming publication of new documentation, such as the 2002 ISDA Master Agreement.

ISDA conducted its dialogue with the Monetary Authority of Singapore (MAS) on the review of the proposed legislation for the legal protection of payment and settlement systems in Singapore. In July and again in November, ISDA submitted comments on the proposed guidelines regarding sound risk management practices for banks treasury and financial derivatives activities as well as a preliminary submission on the proposed "Payment and Settlement Systems (Finality and Netting) Act".

South Korea

The introduction of the 'Corporate Restructuring Promotion Law' and its possible impact on the enforceability of close-out netting as well as collateral arrangements continued to be a source of concern to members active in South Korea. ISDA's Asia-Pacific Steering Committee and Legal & Regulatory Committee pushed for a dialogue with the Ministry of Finance and Economy (MOFE) in Seoul to clarify some of the issues raised. In June 2002, ISDA provided a submission to MOFE on the effect of the CPRL on close-out netting incorporating the views of the members in the region. In June, ISDA also hosted a conference in Seoul on the use of the ISDA Master Agreement and Collateral Documentation.

Taiwan

During 2002, ISDA held two seminars for market practitioners: the first in May covering Collateralization of Credit Risk Exposure; the second in December, providing an overview of ISDA's Documentation and Risk Management efforts.

In December 2002, ISDA visited the Central Bank, the Bureau of Monetary Affairs and the Securities and Futures Commission as well as key representatives of the Banking Association, BAROC, to discuss the future of the OTC derivatives markets in Taiwan.

Thailand

In October 2002, ISDA met with representatives of the Bank of Thailand and hosted a workshop for the Bank on credit derivatives. For the benefit of market practitioners, ISDA held a conference on the Fundamentals of the 1992 Master Agreement.

Regulators' Forum

In May 2002, ISDA conducted a seminar providing insights into its Basel Review Process and other risk management issues of topical interest to the representatives of the East Asia-Pacific Central Banks in Bali, hosted by Central Bank of Indonesia.

Canada

In the past year, the Canada Steering Committee and the Canadian Legal and Regulatory subcommittee met on various occasions to discuss current issues in the Canadian derivatives market and ISDA documentation initiatives. On April 24, 2002, the Committee sponsored a presentation in Toronto on Credit Derivatives for investors, and in January of 2003 ISDA staff made a presentation to members on recent ISDA initiatives.

The legal focus of the past year has been on certain bankruptcy law issues and proposed changes to Canadian legislation in this area. In October of 2002, the Committee submitted a comment letter on "Proposed Amendments to National Instrument 81-102" to the Ontario Securities Commission (OSC). This proposed amendment proposes certain legislative changes with respect to entering into or maintaining a swap position for purposes other than hedging. The OSC responded to the comment letter, requesting that the Committee provide drafting suggestions for the proposed legislation. After circulating proposed language to the Committee at large and meeting in Toronto on January 30, 2003, the Committee submitted drafting suggestions to the OSC.

A draft ISDA comment letter on the Concept Proposal for Uniform Securities Legislation, "Section VI. Trading in Derivatives--The Regulation of OTC Derivatives" was circulated to Committee members in March for comment. The proposed legislation seeks to bring OTC derivatives within the regulatory jurisdiction of securities legislation, and then provide relatively wide exemptions for transactions between "qualified parties". All comment letters must be submitted by May 30, 2003.

Central and Eastern Europe

ISDA continued over the course of the past year to make substantial efforts in assisting the development of an effective legal and documentation infrastructure in Central and Eastern European countries, in order to facilitate trading and use of OTC derivatives in the region.

Poland

Following submission to the lower chamber of Parliament by the Ministry of Finance, the National Bank of Poland and the Polish Banks Association, in cooperation with ISDA, draft provisions on netting and credit support were adopted on February 28, 2003. These provisions are significantly broader than the previously existing law in Poland. ISDA also hosted a seminar for the Warsaw Institute of Banking on European Union and Basel-related issues affecting Poland as an EU accession country.

Hungary

Adoption of close-out netting provisions in Hungary became effective in January 2002. Amendments to ease restrictions on cross-border financial transactions earlier than currently expressed in the Capital Markets Act are being discussed.

Russia

In March 2003, ISDA accepted an invitation from the Committee for Credit Organizations and Financial Markets of the lower house of the Russian State Duma to present industry views on various draft bills, including anti-gaming issues, affecting derivatives trading in Russia.

Slovakia

The Slovak Ministry of Justice took primary responsibility in late 2002 for progressing a review of close-out netting and other provisions submitted by ISDA. The Association has received indications that a stand alone netting act or amendments to the Slovak Bankruptcy Act could be imminent.

Czech Republic

The Czech Working Group met with the Ministry of Finance to discuss changes to Czech insolvency law. ISDA further submitted an explanatory memorandum to the proposed legislative close-out netting amendments to the Ministry of Finance.

Greece

ISDA has commented on the Ministry of Economy and Finance/Hellenic Bank Association co-sponsored draft law on bond loans, securitization of claims and real estate and related matters. The draft bill entered the legislative process in early January 2003, and was due to be submitted to parliament at the end of March.

Collateral

ISDA has continued over the past year to work toward the increased smooth functioning of the process of collateralizing derivatives transactions through its efforts in relation to standards and practices and as legal certainty through the collateral and netting opinions.

In addition to its annual Margin Survey, the ISDA Collateral Committee has undertaken three major projects in the past year. The first of these, the Enterprise-Wide Collateral Working Group, has coordinated input from lawyers and practitioners in the collateral markets to produce a working document that outlines the goals and obstacles to a seamless enterprise-wide collateral process. This document will be released at ISDA's Annual General Meeting in Tokyo in April.

Also scheduled for release at this time is the work of the ISDA Collateral Asset Definitions Working Group. Through this working group, the Committee has established a comprehensive definitional framework that lists and describes all fields of major acceptable assets, cash or securities, utilized in the collateral support process.

Further items of work produced by this Committee are those of the Electronic Data Interchange Standards Working Group. This group has produced various formats for the exchange of standard minimum data between counterparts, ranging from an Excel spreadsheet format to an XML format.

Collateral Law Reform

ISDA and its members have been represented throughout numerous diplomatic sessions in The Hague over the past year to address the Hague Convention on Indirectly Held Securities. The Convention was adopted on December 13, 2002, including several provisions for which ISDA had lobbied the Permanent Bureau of the Hague Conference on Private International Law, such as determination of the location of an account for applicable law.

In May 2002, the European Parliament adopted the European Union Directive on Collateral, aimed at allowing all participants to use collateral to support cross-border payment and security transactions. ISDA continues to work on implementation in EU member states, in light of the newly adopted Hague Convention, in order to raise awareness of domestic issues. ISDA has also begun to participate in regional Hague Convention follow-up projects, such as the Organization of American States (OAS) initiative for the Americas, since February 2003.

ISDA also provided industry perspective to The International Institute for the Unification of Private Law (UNIDROIT) and comments on the scope of the Harmonised Modernisation of the Law Governing Secured Transactions project. The project deals with substantive issues relating to the creation, perfection, and pre- and post-insolvency enforcement of collateral arrangements.

Credit Derivatives

Since its inception in January 2001, the ISDA Credit Derivatives Market Practice Committee has worked to resolve issues arising in relation to business conduct in this burgeoning market, as well as issues affected by the ISDA documentation supporting these products. In 2002, the committee, through its working group, known as the Group of Six, or G6, met weekly to discuss the market practice perspective of some of the issues that would be resolved by the 2003 Credit Derivatives Definitions. The committee also issued a recommendation in relation to T+1 effectiveness of protection on credit default swaps.

2003 ISDA Credit Derivatives Definitions

The market for credit derivatives has evolved rapidly and grown exponentially since its inception in the mid-1990s, while corporate default rates have reached historic highs. Between ISDA's first and second samplings of credit default swap market size in 2002 alone, outstanding notional volumes jumped by 44% to \$1.6 trillion. The evidence shows that this trend continues; participants in the market for credit protection have increased in number and level of activity and these days, few major financial institutions, be they buy-side, sell-side, or both, are without a credit derivatives operation of some kind.

The ISDA documentation for credit default swaps has evolved perhaps more rapidly than it has in any other area of derivatives. In the relatively short time-frame of five years, the ISDA documentation supporting credit derivatives has moved from its original Long-Form Confirmation published in 1998, through the 1999 ISDA Credit Derivatives Definitions via a series of supplements to the extensively revised 2003 Definitions launched in February of this year.

A fast expanding market is often accompanied by tests of the robustness of both the product and its infrastructure. Some major tests of the market have been instrumental in defining this new document. In September 2000, the restructuring of Consec's debt schedule resulted in some participants availing themselves of a so-called 'cheapest-to-deliver option', which enabled sellers of protection to deliver lesser value securities than banks believed they had bought protection on. Participating firms in the credit derivatives market moved to tighten up the loophole in the definitional language, and created a supplemental version of the restructuring credit event that became known as 'Modified Restructuring', which restricts maturity limitation of deliverable obligations to 30 months after the scheduled termination date.

First published in May 2001, Modified Restructuring was widely adopted by the North American market, and is now one of four choices offered in the 2003 Definitions. Under this definition, unlike the original 'Old Restructuring' definition, the deliverable obligation must be fully transferable with no consent required. Ultimately, the European market chose not to trade with this version. A third version, commonly referred to as 'Modified Modified Restructuring' (or 'Mod Mod R'), was therefore developed over the past year.

Under Mod Mod R, the maturity of the restructured bond or loan may be up to 60 months after the restructuring date, but for all other deliverable obligations, the maturity may also be only up to 30 months. Perhaps more significantly, the deliverable obligation must be 'Conditionally Transferable'; therefore consent may not be unreasonably withheld. It is expected the European market will implement this version in the coming weeks.

The fourth choice available under the new Definitions is to trade without Restructuring. This approach has gained support in several areas, and while not a documentation solution per se, demonstrates that the 2003 Credit Derivatives Definitions reflect another stage in the development of a market still in its

relative infancy. As the market continues to develop and mature, the documentation will continue to adapt to its needs.

Documentation

2002 ISDA Master Agreement

The 2002 ISDA Master Agreement represents a fresh landmark in the documentation of the \$90trn over-the-counter derivatives market. In the ten years that have elapsed since the 1992 Master was published, the OTC derivatives markets have burgeoned beyond all expectation. Use of derivatives as the most popular and effective risk management tool has survived and thrived in the wake of market tests brought to bear by the Asian debt crisis in 1997, the Russian debt default and Long Term Capital Management's near-collapse in 1998. That none of these shocks to the financial system brought down the underlying securities markets, nor precipitated any significant bank failures in their wake, is testament to the robust nature of the derivatives markets and their documentation framework, the ISDA Master Agreement.

In spite, also, of several incidents in the mid-1990s that temporarily shook the faith of end-user market participants, the documentation proved robust enough to withstand legal challenges and, just as importantly, played a major role in restoring the confidence and reputation of the OTC derivatives markets.

Originally published in 1987 and last revised in 1992, the Master Agreement plays a major role in the soundness and security of these markets. While the broader network of international law, regulation and supervision, along with netting and collateralization, may provide a firm foundation for the OTC derivatives markets, the Master Agreement represents the architectural infrastructure. ISDA's efforts across the globe in obtaining regularly updated legal opinions in respect of netting and collateral enforceability add further solidity to this structure. The importance of the Master Agreement has even been described by one industry pundit as "no less than the creation of global law by contractual consensus."

Key changes ushered into the 2002 Master include the introduction of a single measure of damages standard, the "Close-out Amount" provision that provides a means of valuing transactions and reflecting the increase in the volume and complexity of transactions over the past decade. This replaces the earlier Market Quotation and Loss methodology of the 1992 Agreement. A further introduction is that of a Force Majeure Termination Event that offers parties the flexibility to terminate transactions impacted by events beyond their control, such as the events of September 11, 2001. Another new introduction designed to mitigate market stress is that grace periods associated with some events of default (including failure to pay and bankruptcy) have been tightened. Further, a set-off provision was introduced, which allows a non-defaulting party to set off payment obligations under the Master against other assets or liabilities of the defaulting party, thereby minimizing credit losses.

The publication of the 2002 Master Agreement in January of this year punctuated a two-year effort on behalf of hundreds of ISDA members representing different perspectives in the marketplace; not only banks and dealers, but also hedge funds and other major investors in Asia, Europe, and North America -- a further sign of the continuing broadening and enriching of these markets.

Other issues addressed in the past year

ISDA published the revised 2002 ISDA Equity Derivatives Definitions and 2003 ISDA Credit Derivatives Definitions in response to industry demand. These documents are discussed in the respective committee sections of this Review.

User's Guide to the 2002 ISDA Master Agreement

The first draft of the User's Guide to the 2002 ISDA Master Agreement was distributed to the Documentation Committee on March 25, 2003. Comments are due on April 18. A second draft is anticipated to be distributed in early May. The target date for publication is September 2003.

User's Guide to the 2002 ISDA Equity Derivatives Definitions

The first draft of the User's Guide to the 2002 ISDA Equity Derivatives Definitions is currently being prepared. The target date for publication is September 2003.

Two Bilateral Form of Amendments

A bilateral form of amendment to the 1992 ISDA Master Agreement was published on March 12, 2003. The amendment permits counterparties to amend their 1992 ISDA Master Agreement to account for the measure of damages provision, Close-out Amount, in the 2002 ISDA Master Agreement.

A draft bilateral form of amendment to the 1994 ISDA Credit Support Annex and the 1995 ISDA Credit Support Annex has been distributed to the Collateral and Documentation Committees on March 14. A final draft will be distributed in mid-April and publication will follow. This amendment permits counterparties to amend their Credit Support Annexes to account for the new measure of damages provision, Close-out Amount, in the 2002 ISDA Master Agreement.

2003 ISDA Protocol

The library of ISDA documents refers in various provisions to the 1992 ISDA Master Agreement and various terms and provisions in that 1992 Agreement. ISDA will offer a first draft of the Protocol at the Annual General Meeting. The purpose of the Protocol is to facilitate the amendment of ISDA definitional booklets and Bridges for those firms who wish to update their documentation to refer to the 2002 ISDA Master Agreement. Target for publication is after mid-year, 2003.

Monoline Confirmation

A fourth draft of the monoline confirmation was distributed on March 28, 2003 to the Credit Derivatives Market Practice Committee. The monoline confirmation is intended to be used for physically-settled credit default swaps where the Reference Entity is a monoline insurance company issuing financial guaranty insurance policies and where the Deliverable Obligations are not limited to Reference Obligations. The target date for publication is April 30.

Multiple Holder Obligation – Recommended Language

A first draft of recommended language to be used for European bonds in connection with Multiple Holder Obligations was distributed on March 31 to the Credit Derivatives Committee. The target date for publication is April 30.

Bankruptcy and Restructuring Triggers

During preparation of the 2003 ISDA Credit Derivatives Definitions, ISDA agreed to hold meetings on the Bankruptcy and Restructuring Credit Event triggers following publication of the 2003 Definitions. It was felt that the discussions could last several months and it was difficult to foresee if a consensus could be reached. Thus, it was agreed to publish the 2003 Definitions and to hold open meetings thereafter to discuss any potential amendments to the two Credit Events. There is no target date in the sense that it is difficult to assess how long the discussions will last and what form any amendments will take.

Master Confirmation

A group of global dealers have been preparing a Master Confirmation to be used with the 2003 ISDA Credit Derivatives Definitions. The Master Confirmation and Transaction Supplement is an abbreviated

form of the Confirmation included as Exhibit A to the 2003 ISDA Credit Derivatives Definitions. The target date for publication is May 2003.

Weather Derivatives Long-Form Confirmation

A Heating Degree Day long-form confirmation for weather derivatives was published on April 2, 2003. A series of other form confirmations, modeled on the original form, will be published in April.

Power and Gas Annexes

Two forms of the *European Gas Annex* were published on March, 2003. A first draft of *The North American Gas Annex* was circulated to the working group in March. This is a joint project with the North American Energy Standard Board (NAESB). The target date for publication is September 2003.

A third draft of *North American Power Annex* was circulated to the working group on March 18. Comments are due on April 8. This is a joint project with the Edison Electric Institute (EEI). The target date for publication is May.

Best Practices Statement

ISDA published a Best Practices Statement on March 25 relating to the proposed change in methodology announced by Platt's European Marketscan for European oil products, effective on April 1, 2003.

2003 ISDA Novation Definitions and User's Guide

Draft Novation Definitions, a Novation Confirmation and a Novation Agreement have been distributed to an operations and documentation working group in February. In addition, a questionnaire was distributed to the Operations Committee on March 26 in order to assess what operational and legal goals should be achieved. Research has also been completed on partial novations under English law. Several tax and accounting issues will be examined in April. The target date for publication of the 2003 ISDA Novation Definitions and User's Guide is fall 2003.

Confirmation Cross-Currency Interest Rate Swap Transaction (Non-deliverable)

This Confirmation was published on March 21, 2003.

Amendments to the 1998 FX and Currency Option Definitions

The first amendment was published on March 3, addressing the Taiwanese Dollar. Amendments are coordinated with the Emerging Markets Traders Association and The Foreign Exchange Committee. A target date is difficult to predict at this point, given that various working groups are considering the 1998 Definitions.

Energy and Developing Products

Inclusion of Commodity Derivatives in the ISD

ISDA has been actively involved in consultation and lobbying since the European Commission first started consulting on the revision of the Investment Services Directive in 2001. In spring 2002, they put a second consultation paper out to the public, which ISDA commented on, and in November 2002, the draft directive was published. The proposal includes commodity derivatives in the directive for the first time as a core service, accompanied by some shakily worded exemptions for specialist commodity dealers. ISDA hopes to achieve clarification on the wording of the exemptions and will continue to support the introduction of a light-touch capital regime for all commodity derivatives trades.

European Gas Annex

The European Gas Annex was published on March 17 2003. The Annex allows European gas contracts, documented under NBP and ZBT, to be tied in to Sections 6 and 7 respectively of the Schedule to the ISDA Master Agreement, enabling the close-out netting of contracts that would otherwise be stand-alone. The Annex has been reviewed by a European dealer group as well as both the Energy Committee and the Documentation Committee before publication.

Weather Derivatives Working Group

This global working group has been working to produce a Long Form Confirmation to the ISDA Master Agreement for weather derivatives. Active regional groups have been submitting drafts and the global group has met by conference call to discuss comments received and produce further drafts. The long form confirmation is close to completion and is likely to be followed by a definitional booklet and a short form confirmation. The 2002 Energy Agreement Bridge, an adaptation of the ISDA Bridge so that it can also be used to bridge physical contracts to the ISDA Master Agreement, was published on October 28. See Press Release of October 28.

Emissions Trading

Initiated by a meeting between ISDA, interested members and the London Stock Exchange, ISDA surveyed members to see if there was sufficient interest in setting up a working group to look at documentation issues relating to emissions trading and how to bring this under the ISDA umbrella.

In the Fall 2002, members of the Emissions Trading Working Group participated in a panel discussion on documenting emissions trades that was hosted by ISDA at a one-day event, "Carbon in the City", organized by the UK Emissions Trading Group to promote the potential of London as the center for the European emissions trading market. The panel discussed why the ISDA documentation architecture would be a useful framework for emissions trading and drew attention to the fact that ISDA will soon be producing documentation for this market. The Working Group itself will hold its first meeting in April.

North American Energy

The North American Energy and Developing Products Committee was active in a broad range of areas in 2002 including; documentation efforts to improve the use of energy documentation with the ISDA Master Agreement; regulatory issues and technology projects. Documentation projects continued to be a primary focus of the committee in 2002 and have included an ISDA Energy Bridge, a weather derivatives confirmation, a North American Power Annex, and a North American Gas Annex. These projects are discussed in more detail under the documentation section. The Committee in conjunction with the North American Regulatory Committee monitored bankruptcy reform legislation designed to strengthen and clarify the enforceability of early termination and close-out netting provisions and related collateral arrangements in U.S. insolvency proceedings and Congressional efforts to regulate energy derivatives trading.

Issues relating to technology focused on FpML (Financial products Markup Language). Discussions have occurred with WRMA and ISDA regarding inclusion of WXML, the Weather Risk Management Association (WRMA) protocol for electronic representation of weather contract details developed to promote standardized, electronic processing of weather transactions and to thereby reduce trading costs and operational risks for weather market participants. Additionally, FpML officially launched an energy derivatives working group that will extend the product coverage of the FpML standard to include products for the following energy markets: Financial Oil, Financial Natural Gas, Physical Natural Gas, Financial Power, Physical Power. Accounting issues also became a focus of the committee as the Financial Accounting Standards Board (FASB) considered Issue No. 98-10 "Accounting for Contracts Involved in Energy Trading and Risk Management Activities. The action addresses a number of valuation issues relating to energy derivatives.

Equity Derivatives

2002 ISDA Equity Derivatives Definitions

A year of consultation culminated in the publication of the 2002 ISDA Equity Derivatives Definitions. The 2002 Definitions thoroughly revise and update the 1996 booklet, expanding product coverage to include forwards, barrier instruments and Bermuda options. The Definitions also reflect developments in market practice, covering a broader range of events and possible responses to them. To accompany the Definitions, 18 confirmation templates may be freely downloaded from ISDA's web-site, and a User's Guide is in preparation for release in the spring.

One fundamental change is that settlement provisions (previously tied to options) can now apply to any instrument. In respect of dividends, however, issues are jurisdiction/transaction-specific and parties must still specify in Confirmations what constitutes an Extraordinary Dividend.

The 2002 Definitions also introduce the concept of Scheduled Trading Day, underlying Exchange Business Day. (Thus, a change to an exchange's schedule need not constitute market disruption). And they posit two types of Disrupted Day: a failure to open (due to a Market Disruption Event, itself a function of Trading Disruption, Exchange Disruption), or an early closing (without sufficient notice).

Upon a disruption, valuation (or averaging) may be delayed by up to eight Business Days, at which point the Calculation Agent intervenes. Similarly, expiration can be delayed, though exercise will still be binding, even on what proves to be a Disrupted Day.

The Equity Derivatives Definitions additionally offer parties more Consequences of Merger Events to choose from. The Definitions also cover tender offers and 'reverse' mergers; Potential Adjustment Events now include the triggering of any ('poison pill') arrangement against hostile takeovers; and new, elective Additional Disruption (termination) Events relate *inter alia* to the ability to borrow stock or hedge. In addition to Nationalization or Insolvency, Delisting can now trigger certain consequences.

Under Consequences of Merger Events, ISDA has added Partial Cancellation and Payment, for use with basket trades. And two alternative mechanisms now support Cancellation and Payment and its 'Partial' variant: Calculation Agent Determination offers flexibility, while Agreed Model prescribes how to reflect changes in factors relevant to option prices, e.g., implied volatility.

For a Share-for-Combined Merger Event, under "Component Adjustment", distinct forms of consideration are treated differently: New-Share consideration as though a Share-for-Share Merger Event has occurred; and Other Consideration as in a Share-for-Other Merger.

To address jurisdiction/transaction-specific considerations, the role of the Calculation Agent is evident in a number of provisions, short of it acting as a fiduciary (Section 1.41). Regarding electronic mail, the ISDA Master Agreements specifically envisage its use in day-to-day communications (though not for notices of default or termination). The 2002 Definitions include 'non-reliance' language, for parties to invoke via Confirmations, and elective disclaimers relating to hedging and index sponsors.

The new Equity Definitions will be covered in the series of ISDA conferences taking place through 2003.

The Equity Derivatives Committee Chairs have in the past year overseen the establishment of a Senior Practitioner Panel, which is intended to advise on issues of global market significance, including establishing closer links with securities and futures exchanges in the interest of furthering best practice.

Japan

Committee activities in many product areas have accelerated over the past year. In June 2002, a Global Working Group in Weather Derivatives began work on drafting a global Weather Derivatives Confirmation Form. The Japan Weather Derivatives Committee has actively coordinated between members and the Japan Meteorological Agency to give practical advice on HDD Swaps and Precipitation Day-count Option deals.

In February 2003, ISDA held a Collateral Seminar for both Collateral Committee members and non-ISDA members. Over 300 participants attended educational sessions on the introduction of CSAs. A range of regional banks and life insurance companies participated.

During the first several months of 2003, the ISDA Documentation, Credit Derivatives and Equity Derivatives Committees held educational sessions on the new Master and Definitions for their members. Based on strong demand from members, ISDA arranged a Japanese translation project with input from Japanese member volunteers. The first draft of the Japanese language version of the Master Agreement was issued in late March.

In July 2002, ISDA hosted a Credit Derivatives Conference at the Imperial Hotel in Tokyo. The event was very well attended, and over 130 participants. It was a timely event, catering to the market appetite for information on developments in the changing Definitions, including the Successor issue, Obligation Acceleration, and Restructuring, not only as these issues affect the region, but also in USA and Europe. A speaker from the Bank of Japan highlighted the relationship between the new BIS treatment of regulatory capital and credit derivatives, assisting in the understanding of market practice and risk management as they affect credit derivatives in the region. There was also a call for increased leadership in helping to grow the Credit Derivatives Market in Japan.

In October 2002, the Japan Market Practice sub-committee was established under the Japan Credit Derivatives Committee. Since its inception, the sub-committee has held several meetings to discuss market-related decisions such as T+1 effective date, standard Credit Events, and an Implementation Date for the 2003 Definitions.

ISDA undertook many lobbying efforts with regulators in the region. In October 2002, ISDA met with members, the Japan Bankers Associations (JBA), BOJ and FSA to discuss the influence of new BIS regulatory capital proposals in respect of the Restructuring event in credit default swaps. There was consensus from Japanese members to ask for the complete removal of Restructuring as a requirement for capital relief purposes.

In November 2002, ISDA provided an official comment letter to the amendment on Bankruptcy Law to the Ministry of Justice. In the letter, ISDA requested the Ministry to increase further efficiency of netting under the ISDA Master Agreement.

In January 2003, the Japan Documentation Committee invited FSA officials to discuss any possible capital injection into the troubled banking sector. Membership marketing in Japan has been accelerated in the past year amid strong concerns to diversify Japanese membership beyond the banking industry toward industries such as governmental agencies, insurance and corporate sectors, for example.

Finally, efforts in preparation for the 2003 Tokyo Annual General Meeting were dedicated throughout the past year. In May 2002, at the Tokyo Member Update, details of the Berlin AGM were reported to

Japanese members. In July 2002, the Tokyo AGM Preparation Committee was established to start fund-raising activities among all Japanese members. These efforts were successfully completed in September. Work continued on selection and recommendation of keynote speakers from the Japanese financial industry throughout the year. The 2003 ISDA AGM takes place on April 9 and 10 at the Four Seasons Hotel at Chinzan-so, Tokyo.

Latin America

Brazilian Credit Derivatives Market

In October 2002, the National Monetary Council on behalf of the Brazilian Central Bank enacted Resolution 3039 (in connection with Article 30 of Provisional Measure 2192-70), implementing final rules in connection with the Brazilian netting and settlement regulations within the national financial system. On November 19, the Central Bank of Brazil republished and amended Resolution 3039 to broaden the triggering events for default (Article 30 provides for the enforceability of netting in Brazil and in 2001 was granted force of law).

At a January 27, 2003 meeting, the Brazilian Subcommittee of ISDA's Credit Derivatives Committee discussed developments in local regulations. ISDA member CETIP, the payment and settlement system, participated in the meeting. CETIP constitutes an organized over-the-counter market for the registration and trading of fixed-income securities and is expected to consider in spring 2003 the registration of credit derivatives, which local ISDA members believe is essential to the development of the Brazilian credit derivatives market. Also, the Brazilian Central Bank issued a normative (Circular 3037) that sets accounting procedures for credit derivatives in mid-January 2003.

A local Master Agreement for domestic transactions in the Brazilian market was developed with input from ISDA and its membership. ISDA also held a conference on Fundamentals of ISDA Documentation in Sao Paulo in early August.

Operations

The Operations Committee reorganized into four new Working Groups in 2002 to work along product and related lines. These Working Groups are: the Interest Rate Products Working Group; the Process Working Group; the Credit Derivatives Working Group; and the Metrics Working Group.

The Metrics Working Group has been working to develop statistics that can be generated efficiently on a quarterly basis by a representative number of firms, focusing on performance in relation to trade confirmations (including the automation of matching of confirmations), initially in the area of interest rate derivatives. The aggregate data is intended for those firms that have contributed to the exercise, but the Working Group is to advise the Operations Committee and its sister Working Groups of any significant issues raised by the data. The exercise is also intended to complement the information gathered in the annual Benchmarking Survey.

The Interest Rate Products Working Group continued to work on additions to its Cash Settlement Matrix for Early Terminations and Swaptions, the most recent revisions being made on July 1, 2002 and January 2, 2003.

In addition, the N2 Working Group was formed to deal with issues arising from the UK FSA's new approach to supervision of firms from November 2001, particularly as they affect back offices. ISDA worked successfully with the FSA and jointly with the London Investment Banking Association to ensure

that the rules regarding trade confirmations were in line with reasonable market practice and that, where relevant, firms could obtain a waiver from inappropriate rules.

ISDA published a Novation Agreement in May 2002 and subsequently organized a Novations Working Group to examine ongoing broader issues, such as assignments without consent (see also Trading Practice).

The ISDA 2002 Operations Benchmarking Survey was published in July of last year, demonstrating higher rates of automation in the OTC derivatives area and lower volumes of outstanding confirmations in the core product areas. The 2003 Survey results are anticipated in June.

Finally, the Operations Committee has instituted an Operations Summit, which it anticipates will become an annual industry event. This is a forum for promoting communication by exchange of contact information, and for identifying confirmation issues that delay process. The summit includes breakout sessions on Credit Derivatives and Interest Rate Products.

Regulatory

Europe

Investment Services Directive

ISDA has responded to the second consultation on a revised ISD and attended public hearings. A new proposal was published in November 2002. ISDA subsequently published a joint position paper with other trade associations (LIBA, TBMA, ISMA among others) and is co-ordinating advocacy activities in Brussels. ISDA's key concerns include the best execution regime, conduct of business and client order handling rules and transparency requirements. The proposed abolition of the concentration rule and the full application of exclusive home/branch country regulation, on the other hand, are welcome initiatives.

In the commodity derivatives area, ISDA's other main concern in this Directive, ISDA has undertaken joint work with Energy and Developing Products Committee. ISDA has strived to reach a solution which responds to the concerns of its varied membership.

Market Abuse Directive

In February of 2002, the European Parliament adopted several amendments that reflected ISDA's views. ISDA has continued to liaise with national delegations in the European Council. A common position was reached in the Council in July 2002. ISDA liaised with Members of the European Parliament (MEPs) during a second reading in the fall of 2002. The Directive was adopted in December 2002 and was the first directive to be adopted under the Lamfalussy procedure. It will therefore require the Commission to adopt implementation measures at level II. ISDA is continuing to follow CESR's and the Commission's work at level II.

Committee Of European Securities Regulators' Conduct Of Business Rules

ISDA has responded to the consultation and attended several meetings with the Committee of European Securities Regulators (CESR). CESR's rules were adopted in June 2002. ISDA and its membership deem the final result shows good progress. Most Member States will wait for outcome of the new ISD before implementing the new Rules.

CESR'S Standards For ATSS

The Second round of consultation ended in March 2002. ISDA's response focused on the importance to concentrate only on multilateral trading systems. The standards were adopted in June 2002 and are limited

to multilateral trading systems. Most Member States, with the notable exception of the UK, will wait for the outcome of the new ISD before implementing them. The UK FSA held a public consultation on its implementation of the standards, which closed in late January 2003. The FSA is now considering responses before deciding its next steps. While most responses advised FSA to wait for ISD2 before implementing, FSA looks likely to go ahead, but to amend some of the more controversial aspects of its original proposal.

Lamfalussy Reform

EU Finance Ministers have proposed the extension of the Lamfalussy reform to the banking and insurance sectors.

ISDA has responded to the consultation by supporting the principles of this reform. Discussions between the European institutions as well as national governments have currently brought the proposed reform to a stalemate.

National Issues

UK: Short-Selling

ISDA has responded to the UK FSA's Discussion Paper 17, which deals with issues associated with short selling in the UK equities markets.

Germany: Cross-Border Business Into Germany

Germany is revising its approach to business conducted by non-EEA providers into its territory. ISDA is liaising with local associations to ensure that such changes to the regime do not make cross-border business excessively burdensome.

North America

Energy Derivatives Legislation

The threat of regulation of OTC derivatives in response to Enron increased significantly in 2002 as policymakers and regulators struggled to address issues arising from Enron's December 2001 bankruptcy. ISDA's North American Regulatory Committee played a leading role in impacting public policy discussion relating to efforts to regulate derivatives following the Enron bankruptcy. Throughout the year, ISDA worked to oppose inappropriate initiatives to regulate energy and metals swaps. The Association's position on Enron-related issues is documented in testimony delivered before the Senate Agriculture Committee on July 10, 2002. ISDA also coordinated the industry coalition opposing these efforts by preparing and distributing legal analysis and organizing industry-wide letters to House and Senate Members. ISDA also conducted a Senate staff briefing on the OTC derivatives industry in Washington, D.C. on June 7, 2002.

Proponents of additional OTC derivatives regulation argued that Enron's ability to deal in complex unregulated financial derivatives in the energy markets led to its collapse and provided Enron the ability to manipulate market prices in California. Arguments supporting additional government regulation of energy and metals swaps were put forth as necessary to prevent these types of situations from occurring in the future and in order to restore confidence in the energy markets. The legislative initiatives listed below were considered in the United States Senate in 2002.

As outlined in ISDA's April 2002 Enron report "Corporate Governance Failures, Not Derivatives, Led to Enron Collapse", the Enron failure demonstrated a failure of corporate governance, in which internal control mechanisms were short-circuited by conflicts of interest that enriched certain managers at the expense of the shareholders. Although Enron made use of OTC derivatives, there is no indication that OTC derivatives contributed in any significant way to Enron's collapse. ISDA does not believe expansion

of CFTC jurisdiction with respect to OTC derivatives is justified due to Enron's collapse. The legal certainty provisions of the CFMA and the related provisions of the Bankruptcy Code may have enhanced the ability of market participants to deal effectively with events such as the collapse of Enron. It has also been alleged that Enron and others engaged in transactions that were intended to manipulate the cash markets for electricity and natural gas in California and that these activities constitute an independent basis for expanding the CFTC's regulatory authority with respect to OTC derivatives. These allegations of manipulation are profoundly disturbing, and ISDA considers it prudent that the appropriate legislative bodies and regulatory authorities investigate them expeditiously and completely.

Senator Feinstein's Energy Derivatives Legislation (S.2724) intended to provide regulatory oversight over energy trading markets and metals trading markets was introduced on July 11, 2002. This initiative was offered as an amendment to the Senate Energy legislation, S. 517, and was defeated on procedural motion by a vote of 50-48. ISDA's analysis of the legislation determined that the legislation would: significantly undermine the legal certainty achieved in the Commodity Futures Modernization Act of 2000 by requiring market participants, in determining their own regulatory status and the regulatory status of derivatives, to rely on distinctions that have proven untenable in the past; affect transactions in a range of products that are not limited to electricity and natural gas and thus go well beyond issues raised by the California energy crisis and the Enron bankruptcy; potentially regulate a range of market participants that have not previously been subject to regulation under the Commodity Exchange Act (CEA) including market participants that are not dealers; regulate systems that are not trading facilities, potentially including corporate procurement systems, used to enter into transactions in a range of products; establish unclear jurisdictional divisions between the Commodity Futures Trading Commission (CFTC) and the Federal Energy Regulatory Commission (FERC) that are likely to consume significant resources in inter-agency jurisdictional disputes.

Senate Agriculture Committee Chairman Harkin and Ranking Member, Senator Lugar put forth a compromise draft to Senator Feinstein's proposal (S.2724) for consideration by the Senate Agriculture Committee. This draft was similar to S.2724 and was not ultimately considered by the Senate Agriculture Committee in 2002.

Bankruptcy Reform Legislation (S. 420/H.R. 333)

ISDA continued to work to pass legislation by year-end 2002 to strengthen and clarify the enforceability of early termination and close-out netting provisions and related collateral arrangements in U.S. insolvency proceedings. Unfortunately, the legislation failed to pass as a part of the larger Bankruptcy Reform legislation the 107th Congress due to controversial provisions that would block abortion protesters from filing for bankruptcy to avoid paying court-ordered fines and judgments. The House of Representatives passed H.R. 333, the Bankruptcy Abuse Prevention and Consumer Protection Act in the final hours of the session on November 15, but the Senate refused to consider the legislation without the abortion provisions effectively defeating the legislation for the session.

Regulation W

On October 31, the Federal Reserve approved Regulation W relating to Sections 23A and 23B of the Federal Reserve Act. Section 23A contains limitations on a bank's transactions with any single affiliate in order to ensure that all transactions between a bank and its affiliates are consistent with safe and sound banking practices, and requires that a bank's extensions of credit to affiliates be appropriately secured. Derivatives transactions have not been deemed extensions of credit for purposes of Section 23A. Section 23B requires that certain transactions between the bank and its affiliates occur on market terms. Preliminary review suggests a favorable regulation in context of ISDA comments submitted in August of 2001, which focused on 1) derivatives transactions between banks and their affiliates, 2) intraday extensions of credit by Banks to their affiliates, and 3) readily identifiable and publicly available market quotation. As outlined in the Final Draft Rule on October 31, the Fed is contemplating issuing a proposal

for public comment on 23A treatment of derivatives transactions that are functional equivalent of a loan by a bank to affiliate or the functional equivalent of an asset purchase by a bank from an affiliate. ISDA met with the Fed in January 2003 for the purposes of discussing issues relating to transactions that are a functional equivalent of a loan. Regulation W cites a purchase of a deep-in-the-money option by a bank from an affiliate as a loan-equivalent derivative and a credit default swap under which a bank agreed to compensate an affiliate for any default of a loan asset held by the affiliate as an asset-purchase-equivalent derivative. Issues relating to the definition, valuation, hedging, netting and collateralization of loan-equivalent and protection derivatives were discussed with the staff. ISDA noted the importance of an objective approach to the issue that incorporates the economic and business reality of the transaction. The Association also stated that the measurement of covered transactions should be based on a daily mark-to-market basis rather than on a notional basis, which does not reflect related risk.

Durbin-Delahunt Legislation

The Employee Abuse Prevention Act (S.2798/H.R. 5221) would have imposed reforms to the Bankruptcy Code affecting corporate practices relating to savings and retirement funds of employees and retirees. Concern existed about certain sections of the legislation (Section 102), which could throw doubt recharacterization of a number of swaps transactions as secured loans. The House Judiciary Committee in large part due to objections raised by the industry.

CFMA Amicus Brief

ISDA, the Bond Market Association and the Securities Industry Association filed an amicus brief on February 22, 2002 in response to *Cary Oil Co., Inc. v. MG Refining and Marketing*, which has called into question the retroactivity of the non-repudiation provisions of the Commodity Futures Modernization Act of 2000 (CFMA). The provisions in question amended section 22(a) of the CEA to provide a safe harbor so that excluded transactions would not be voidable based solely on the failure of the transaction to comply with the terms or conditions of an exclusion or exemption from the Act or CFTC regulations. Also relevant is pre-existing language in section 25 that states "the provisions of this section shall become effective with respect to causes of action accruing on or after the date of enactment of the futures trading act of 1982." On October 23, 2002, the US District Court rejected arguments presented in the ISDA, BMA and SIA amicus brief. United States District Judge, Victor Marrero, found that the contract enforcement provisions of the CFMA did not apply retroactively to the transactions at issue in the case. However, on the same day in the New York Supreme Court, Judge Herman Cahn in *Dreyfus v MG* noted his disagreement with Judge Marrero's decision in *Cary Oil v MG* stating that the court found Congressional intent to be clear on the issue of retroactivity.

Risk Management and Research

Over the course of 2002, ISDA continued to focus on Basel Accord reform in the wake of the publication by the Basel Committee of a number of significant consultation papers, regarding in particular the treatment of credit risk mitigation, securitization and operational risk. Meetings with individual regulators and a number of Basel Committee working groups were an opportunity for ISDA to campaign in favour of a more risk sensitive capital treatment of OTC, and in particular, credit, derivatives.

ISDA also established a fruitful dialogue with the newly established Accord Implementation Group of the Committee, tasked with ensuring that supervisory practices converge by 2007.

In the field of research, ISDA has focused on increasing response rates, on automating the Survey forms, and on stabilizing the Survey questions in a way that facilitates the tracking of trends.

Risk Management

Comments on QIS3 Technical Guidance and CAD3

The Basel Committee issued the QIS3 Technical Guidance in October 2002 as a prelude to their third and last consultation paper, expected for May 2003. ISDA submitted extensive comments in December, insisting in particular on the need for continuing work on: (i) the recognition of portfolio credit risk modeling; and (ii) the counterparty risk treatment of securities financing transactions and OTC derivatives. In the shorter run, correcting the suggested treatment of credit risk mitigation was an absolute necessity.

Among the finer issues raised in ISDA's commentary, the need for developing maturity adjustments below one year, as well as for a more detailed definition of economic loss was stressed. ISDA appended to its response detailed research into credit default swap (CDS) add-ons, advocating the adoption of a 3% add-on for CDSs referenced to qualifying underlyings.

The EU Commission Services published their first draft directive (commonly known as CAD3) on "Capital requirements for credit institutions and investment firms" in November, for comment by the end of January 2003. This directive aims at implementing the New Capital Accord in the EU. ISDA responded jointly with the London Investment Banking Association (LIBA), focusing on the treatment of investment business. Key issues included the need for parallelism as far as appropriate with Basel, legislative flexibility and consistent implementation of the new capital regime across the EU. ISDA and LIBA participated in a Commission Hearing held on 28 January 2003 and will meet bilaterally with Commission officials during 2003.

The full text of the ISDA response to the Basel Committee and to the EU Commission can be accessed on the website.

Credit Risk Mitigation

The ISDA membership remains concerned by the treatment of credit risk mitigation techniques embedded in the QIS3 proposals, and has advocated a change of the regulatory approach to repos, credit derivatives and securitization.

ISDA united forces with LIBA, The Bond Market Association (TBMA) and the Risk Management Association, to advocate the recognition of portfolio VaR measures of exposure for repos. We enjoyed a significant victory when the Credit Risk Mitigation Sub-group of the Basel Committee accepted to include these approaches within the scope of the New Accord, and furthermore abandoned its previous requirement for ex ante multipliers to apply. Ex post backtest multipliers remain however, which create such cliff effect -- basically doubling capital requirements where the exception threshold is crossed -- for firms that they may render the approach inapplicable. Further dialogue is planned with the CRM Sub-group on this issue once CP3 has been issued.

As far as credit derivatives are concerned, ISDA was able to successfully defend the view that capital relief is warranted in most cases without the need for the derivative to hedge restructuring risk. We hope that CP3 will confirm our understanding of where the Committee's thinking currently lies on this point. Another bone of contention is the treatment of double default risk, where ISDA continues to advocate the adoption of a more reasonable approach than substitution.

Finally, the Securitization Group of the Committee issued a Second Working Paper on the capital treatment of securitization in October 2002, which ISDA commented upon jointly with the European Securitisation Forum, the American Securitization Forum and the International Association of Credit Portfolio Managers. The very detailed comment paper particularly highlighted the need for simplifying the Supervisory Formula Approach and rendering the Ratings Based Approach risk weights less punitive.

A roundtable was organized with the Securitization Group to further present the industry's case. This was followed by various bilateral contacts with the FRB and the Bank of England.

All the comment letters mentioned above are available on the website.

Counterparty Risk

ISDA, despite receiving a clear indication from the Committee that a review of the counterparty risk treatment of OTC derivatives was excluded from the scope of the New Accord, continued to urge the regulators to amend the current add-ons based methodology.

The Counterparty Risk Working Group of ISDA refined its earlier proposals to capture degrees of exposure correlation observed in realistic OTC derivatives and repo portfolios. The Group also agreed to run a counterparty risk survey, the contents of which were agreed with the Models Task Force of the Basel Committee, with a view to informing regulators on potential future exposure measurement practices at ISDA member firms.

ISDA was able to secure the support of LIBA and TBMA for its counterparty risk advocacy initiative, and hopes to achieve prompt progress with the Basel Committee in 2004.

Operational Risk

The Operational Risk Working Group (ORWG) has focused on five main issues, all of them related to the proposed new Basel Accord (Basel II) and the equivalent European Union legislation, the Third Capital Adequacy Directive (CAD III):

- 1) Expected Loss;
- 2) Basel 'Rules' Language (ie, the draft Basel II Accord);
- 3) Basel's 'Sound Practices' paper;
- 4) Implementation, especially the UK FSA's Operational Risk Industry Advisory Group, with an emphasis on quantitative issues under advanced approaches to capital.
- 5) The European Union's specific proposals

In addition, ISDA has closely monitored the development of initiatives to pool loss data.

In May 2002, ISDA delivered to the Risk Management Group (RMG) of the Basel Committee a ground-breaking paper on the treatment of expected loss under the new capital rules. This argued that firms' coverage of 'expected' loss (in the non-statistical sense, ie predictable loss) by means other than capital (for instance, provisions) should be recognized, subject to certain conditions. These conditions include the need for a consistent, systematic approach, entailing robust validation.

In September, ISDA responded to a pair of papers from the RMG. It suggested various improvements to the text, to ensure that the Rules (and the proposed 'Sound Practices for the Management and Supervision of Operational Risk') not be overly prescriptive. ISDA argued that it was appropriate to keep an open mind about recognition of insurance.

ISDA participated in discussions organized by UK FSA, which took a lead among regulators in examining implementation issues arising from the prospective rules (and the 'Sound Practices' paper). In particular, ISDA focused on technical discussions on quantitative techniques under the "Advanced Measurement Approaches". This included issues such as the confidence level, loss distributions and correlations. As a follow-on to this, ISDA has embarked on a "Roadmap" exercise, designed to establish common features among and in relation to advanced approaches to the management of operational risk.

The EU issued a consultation in November, proposing to diverge from the Basel rules in relation to insurance (offering greater recognition) and investment firms (offering concessions in relation to certain business lines). ISDA offered technical advice on both these issues, in both its written response and at a specially focused hearing with the Commission in Brussels in January 2003.

Internal Ratings Working Group

The Internal Ratings Working Group was set up in 1999 to contribute to regulators' education on Internal Ratings in the context of the Basel Accord reform. ISDA increased its focus on Internal Ratings throughout 2002 and this working group, chaired by Michel Crouhy of CIBC, has contributed to the launch of the Internal Ratings Validation Survey (section 5-), official industry comment on the Second Consultation Paper (CP2) of the Basel Committee, consultation on implementation at the national level with the UK FSA, reaction to the Technical Guidance of the Third Quantitative Impact Study (QIS 3), and working on implementation at the international level with the Accord Implementation Group (AIG).

Credit Risk Implementation Advisory Group (UK FSA) – ISDA has been working with this FSA group since its creation, and has recently submitted a paper on assessment horizons in internal ratings for the regulator and the UK industry representation to discuss. The conclusions and recommendations in the paper were broadly agreed and will hopefully contribute to the regulator's thinking and Implementation Paper (IMP 2) due in July of this year. In other areas the discussion has led to ISDA raising concern at the international level through its work with the Models Task Force (e.g. the FSA's interpretation of LGD). ISDA hopes that these actions result in changes to the Accord which clarify the Committee's intentions and help national regulators implement and interpret the right policies and definitions. These changes will hopefully be made to the Third Consultative Paper (CP3) due for publication in May 2003.

The Accord Implementation Group – AIG (Basel Committee) – ISDA believes that work with the AIG is critical to ensure a fair and consistent implementation of the New Accord across the world. Up until 2002 focus has been on policy in Basel II, but as many of the policy issues are resolved and changes are worked into the language of the Accord (CP 2, QIS 3, and finally CP 3), the industry's attention must turn to implementation. Interpreting the Accord at a national level is no easy task. Implementation raises many questions, and ISDA will attempt to raise the key concerns, as identified by the members of the IRWG with the AIG. These may include, minimum standards, transition periods, rollout plans, materiality, definition of terms, validation, data quality, use of external models and data, the role of senior management, and procyclicality. ISDA will be meeting with the AIG in April 2003 to discuss the broad topic of "data challenges" in implementation.

Asia

Since the establishment of ISDA Japan Risk Management Committee in 2001, the Committee members have continued to focus on the issues in the New Basel Accord, such as its treatment of the securitization and the restructuring credit event in credit default swaps. ISDA has aggressively held the conversations with Japanese regulators to bring the issues into focus and to exchange the views to promote better understanding of reciprocal arguments.

Implementation of the New Basel Accord has become an important issue as well for Asian memberships. Asia-Pacific LGD Study, a study for a pooled database of Loss Given Default statistics co-sponsored with RMA (Risk Management Association), has been launched in August 2002, by the establishment of the Steering Committee consisting of 6 representative members from 5 countries in the region. The Steering members have worked on the definitions of data fields to be used in the Study, which was finalized in early 2002. ISDA and RMA will start recruiting the other participants in the second quarter of 2003.

Internal Ratings Validation Survey

The Internal Ratings Validation Survey was launched in the late summer of 2002, in association with the BBA and the RMA. ISDA members chose PriceWaterhouse Coopers as consultants to the project, and the

Survey Report is due to be published in May 2003. The report is not intended to recommend standards, or to advocate their adoption. Rather we intend to develop a reference framework to help the industry and supervisors in the implementation of the new Basel standards. The benefits will be realised through the identification of common industry issues related to validation, and approaches to their solution, the identification of trends in approaches to validation, and improvement of the knowledge of the banking and regulatory communities as to industry practice leading to avoidance of duplicated effort and imposition of restrictive requirements. ISDA, the BBA and the RMA will launch the survey with two implementation events planned both in New York and in London in June 2003.

Risk Management Seminars

The London Risk Management Seminars have proved increasingly popular throughout 2002 / 2003, with attendances averaging close to 100 members – not bad for a mid-week evening event. This has been helped by our partners in the series, PRMIA, who continue to grow their London chapter exponentially. We have also ensured a high quality of speakers covering a wide range of risk management issues. Topics for these events have included operational risk, credit risk, legal risk, default correlations, the practical implications of Basel II, enterprise-wide risk, and many more. The Seminars continue into 2003 with record attendances and more quality speakers. These are free events out on by ISDA to promote our work in Risk Management and for the benefit of our membership.

ISDA occasionally invites speakers from the academic, the regulatory, or the business world to present and discuss Risk Management topics that are of interest to our members. The seminars provide useful updates on industry best practice and research in the field of risk management. These are free events sponsored by ISDA to promote our work in Risk Management and for the benefit of our membership.

The New York Risk Management Seminar luncheons have focused on issues of credit risk measurement, beginning in February 2002 with New York University Stern School Professor Ed Altman's paper on credit spreads. Future seminars are likely to concentrate on issues of Basel Accord implementation.

Research

ISDA concentrated during 2002 on automating the three ISDA Surveys – the Market Survey, the Margin Survey, and the Operations Benchmarking Survey – as well as on expanding the base of firms responding and on extrapolating industry trends.

The ISDA Market Survey, which has been conducted twice a year since 1987, measures notional outstanding volumes of selected contracts at ISDA Primary Member firms. Several significant changes occurred during the 2002 Market Survey cycle. First, the Mid-year 2002 Survey added equity derivatives – defined as privately negotiated equity forwards, swaps, and options – to the vanilla interest rate and currency derivatives and to the credit default swap numbers already collected. Second, participation in the Market Survey expanded significantly, from 81 respondents for the Year-End 2001 Survey to 110 for the Year-End 2002 Survey. Finally, the timeliness of announcing the results has steadily improved. The Year-End 2001 Survey results, for example, were announced in April 2002 at the Berlin AGM, a lag of 3½ months between distribution of questionnaires and publication of the results. The Year-End 2002 results, in contrast, were announced in mid-March 2003, cutting the lag by a full month. Given the existence of competing surveys, ISDA will continue to attempt to reduce the lag to publication, a major differentiating trait of our Survey. Information on the ISDA Market Survey, as well as on other surveys, is available along with historical Market Survey data at www.isda.org

The ISDA Margin Survey, which has its origins in the 1999 ISDA Collateral Review, has also seen progress. First, the number of firms responding grew from 43 for the 2001 Survey to 71 for the 2002 Survey. Second, the timeliness of the Margin Survey has improved, with the 2002 Survey issued in November 2002 compared with January 2002 for the 2001 Survey; this is due in large part to changing

the questionnaire from paper to spreadsheet format, which significantly speeds up processing time. The 2003 Survey, however, will show a far greater improvement, with preliminary results to be announced at the 2003 AGM and publication shortly afterwards. The Survey itself changed little from 2002, which will make it possible to track and extrapolate trends in collateral management.

Finally, the Operations Benchmarking Survey, which began in 2000, has stabilized sufficiently in content to make it possible to illustrate trends in such areas as trade volumes, error rates, confirmations processing, and automation. In order to make the trends more visible, the 2002 Survey, which was published in July 2002, relied more on graphs and charts than did previous Surveys. Further, the 2002 Survey expanded its coverage from mostly vanilla products such as FRAs and interest rate and currency swaps to growing products such as credit and equity derivatives. The major innovation for the 2003 Survey, which has a projected publication date of July 2003, is to automate the questionnaire by converting it to spreadsheet format. Once the automation process is complete, ISDA should be able to speed up publication time in a manner similar to the other ISDA Surveys.

ISDA also participates in surveys with other organizations in the risk management area. In addition to the Internal Ratings Validation Survey mentioned above, ISDA participated in two other surveys relevant to risk management. First, ISDA, along with the London Investment Bankers Association and The Bond Market Association, conducted a Counterparty Risk Market Practice Survey, which upon completion in 2003 will be presented to the Basel Committee Models Task Force. Second, ISDA, along with the International Association of Credit Portfolio Managers and RMA – The Risk Management Association, sponsored a Survey of Credit Portfolio Management Practices. All the above mentioned surveys are available at ISDA's Website.

Risk Management Seminars - 2002

DATE	TOPIC	PRESENTER	LOCATION
January 11	Analyzing and explaining default recovery rates	Edward Altman, New York University	New York
February 13	A universal performance measure	Con Keating, Finance Development Centre	London
March 13	Dinosaurs in a portfolio	Mark Freydefont, Moody's	London
March 21	Hybrid contingent claims models: A practical approach to modeling default risk	Sean Keenan and Jorge Sobehart, Citigroup	New York
April 10	Operational risk in e-trading	David Wood, ABN Amro	London
May 6	The perception of time, risk and return during periods of speculation	Emanuel Derman, Goldman Sachs	New York
May 12	Combating Rogue Trading	Geoff Kates, Lepus	London
June 12	Operational risk on everyone's desk - The RADAR system	Jonathan Howitt, DkW	London
July 10	Legal risks on derivatives "What's hot, what's not"	Carolyn Jackson, A&O	London
August 14	Counterparty due diligence	Craig MacDougall, ABN Amro Futures	London
September 10	The practical implications of implementing Basel II	Panel	London
October 14	Correlation: Empirical Evidence	Arnaud de Servigny, S&P Risk Solutions	London
November 13	The art of creating value from the intangible?	Craig Kersey, Guildhall	London
December 3	Market risk management of investment portfolios	Riccardo Rebonato, RBOS	London

Risk Management Seminars – 2003 to Date

DATE	TOPIC	PRESENTER	LOCATION
January 15	Current and future trends in risk	Panel	London
February 14	Default correlation: empirical evidence	Olivier Renault, S&P Risk Solutions	New York

Tax

Europe

Following the publication of the new UK finance bill in 2002 ISDA has been aware of the difficulties involved in getting further amendments tabled. However we continue to monitor this process and have been actively involved in the Workshops held at the Inland Revenue on the Guidance and Explanatory Notes for the Bill. We have also put tax materials together for 2002 ISDA Master Agreement. The ISDA Tax Committee has helped with the tax provisions for the recently published 2002 Master Agreement. On going work in 2003 includes co-operating with the North American Committee on ISDA's work with the ratings agencies, and work in the US with the Internal Revenue Service.

North America

ISDA's North American Tax Committee issued a comment letter, followed by discussions with Department of Treasury representatives on the temporary tax shelter regulations issued by the IRS and Treasury in October 2002. The temporary regulations contain amendments related primarily to the disclosure rules and the list-maintenance rules for "material advisors" of potentially abusive tax shelters.

Tax Committee members outlined the Association's recommendations in a comment letter submitted to the IRS in December: (1) eliminating burdensome disclosure requirements for routine ordinary course of business transactions; (2) providing a safe harbor from the list maintenance requirements of the promoter regulations' for non-material tax advice (3) obtaining transitional relief from these complex regulations effective January 1, 2003 (although certain rules apply to all post-February 28, 2000 transactions).

On January 17, 2003 the IRS issued various modifications to the effective dates of the temporary regulations, including a revised definition of material advisor. ISDA believes the revised definition will still be broad enough to impose the list-maintenance requirements on persons who promote potentially abusive transactions, while taking the compliance burden off persons who make general tax-related statements but who are not providing material tax advice in furtherance of a transaction.

ISDA has also commented on a withholding tax issue for credit default swaps, asking that the IRS treat them as financial instruments for tax purposes. ISDA held a meeting with Treasury on this issue and continues to have correspondence on the issue.

Technology and FpML

2002 was the year Financial Products Markup Language (FpML) became fully integrated into the ISDA organizational structure. The transition was completed in January, bringing to conclusion the rationalization of resources of the two organizations. While ISDA now replaces FpML.org as the host organization, the standard name remains FpML.

In terms of progress in the FpML standard itself, version 2.0 went into full Recommendation on February 26, 2003. (The steps for adoption are: the Working Draft; Last Call Working Draft; Trial Recommendation; and ultimately, Recommendation). Version 3.0 of FpML went into Last Call Working Draft in September 2002, at which point there was also a 'free' (non-authoritative) schema translation of this DTD (Document Type Definition)-based standard.

Version 4.0, which is schema-based, will go into the Working Draft stage in April 2003. This version introduces Equity and Credit Derivatives to the standard, as well as a Messaging capability. An Editor-Viewer will also be made available at this stage. A German language translation is available for the Version 4.0 Equity Derivatives standard.

The organization has added new Working Groups on Validation, Energy, Credit Derivatives, Equity Derivatives, and Messaging. Technical papers addressing extensibility and versioning are available to members wishing to extend the standard within their own firm. Also available at the fpml.org site is a new Tools section, as well as discussion group facilities for each asset class.

The first ISDA FpML conferences were held in the fall of 2002 and were well attended in both London and New York. They will be followed by the first seminar in the Asian region, to be held in Tokyo, April 2003.

Trading Practice and ISDAFIX

Assignment of Trades

The ISDA Board has discussed recent experiences regarding parties assigning transactions governed by the ISDA Master Agreement without the consent of their counterparty or seeking to obtain consent after the fact. This practice creates issues for the operations, collateral, valuations, documentation and other areas. ISDA has circulated a draft memo on assignment without consent that members may ask counterparties to sign to indicate they will not enter into such practice.

The memo was circulated to the Trading Practice, Operations and Documentation Committees for review and is available on request from ISDA.

ISDAFIX

The ISDAFIX daily benchmark service was expanded in 2002 to incorporate a daily fixing for the Hong Kong dollar. Discussions are underway with the partners to the contract, Garban Intercapital and Reuters, to add frequency of fixes to various countries and to expand distribution of the rates to other media.

MEMBERSHIP

ISDA's member benefits, level of activity and the importance of issues addressed throughout the year continued to fuel a significant increase in its membership. Since January 2002, 96 new members have joined the Association. ISDA's membership now totals 600 financial institutions, government entities, corporations and professional service providers, spanning over 46 countries in six continents. ISDA continues to work through its active committees, task forces, working groups and educational programs to focus on specialized areas and address areas of particular concern.

The Association's 600 member institutions from 46 countries are classified into three categories according to the guidelines contained in the Association's by-laws. These categories are Primary (dealer firms), Associate (service providers) and Subscriber (end-users). Below is a description of each category as well as some of the benefits of membership.

Categories of Membership

Primary Members

According to the Association's by-laws, every investment, merchant or commercial bank or other corporation, partnership or other business organization that, directly or through an affiliate, as part of its business (whether for its own account or as agent), deals in derivatives shall be eligible for election to membership in the Association as a Primary Member, provided that no person or entity participates in derivatives transactions solely for the purpose of risk hedging or asset or liability management.

Associate Members

ISDA's Associate Membership category is designed for service providers -- brokers, law firms, accounting firms, consulting firms and software providers - who are active in the privately negotiated derivatives business. Associate Membership provides a forum for these industry participants to stay abreast of and contribute to important developments and initiatives.

Subscriber Members

ISDA's Subscriber Membership category is designed for corporations, financial institutions and government entities and others who use privately negotiated derivatives to better manage financial risks. Subscriber Membership provides a forum for these industry participants to stay abreast of and contribute to important developments and initiatives.

Benefits of Membership

ISDA Legal Opinions

Only ISDA members are entitled to receive the Association's legal opinions on the enforceability of the netting provisions of the ISDA Master Agreements, which enable institutions to reduce credit risk and consequently capital requirements in jurisdictions subject to BIS capital regulations. ISDA has obtained netting opinions for 39 jurisdictions. In addition to the netting opinions, ISDA provides members with legal opinions on the ISDA Credit Support Documents from 33 different jurisdictions. The collateral opinions assist members in ensuring the validity and enforceability of collateral arrangements entered into pursuant to the ISDA Credit Support Documents to provide credit support for transactions under an ISDA master agreement

Only ISDA members are able to participate in the Association's numerous committees, working groups and task forces, which serve to address issues in the rapidly evolving derivatives market.

Only ISDA members receive the numerous policy papers, response letters, market survey data, and communications on key business issues that ISDA and its consultants generate.

ISDA members receive substantial discounts when ordering copies of the Master Agreement and supporting documents that are published by the Association and widely used to document privately negotiated derivatives transactions. Primary Contacts at member firms receive complimentary copies of all new publications upon their release.

Conference participation

Only ISDA members are eligible to attend the Association's annual general meeting, which is the industry's preeminent forum for the discussion of developments and issues in the privately negotiated derivatives business. In addition, a strong preference is given to enlisting speakers from ISDA member firms at the association's numerous conferences and seminars.

Following is a list of the association's members. Firms in italics are those that have joined since January 2002.

PRIMARY MEMBERS

ABAXBANK S.p.A.	Caixa Geral de Depositos, SA.
Abbey National Financial Products	Caja de Ahorros Y Monte de Piedad de Madrid
ABN AMRO Bank N.V.	Calpine Energy Services, L.P.
ABSA Bank Ltd.	Capitalia Spa
Accord Energy Limited	Cargill Financial Services Corporation
Ace Guaranty Corp.	CCF
<i>AEP Energy Services, Inc.</i>	CDC IXIS Capital Markets
African Merchant Bank Limited	Ceskoslovenska Obchodni Banka, A.S.
Allegheny Energy Supply Company	Chuo Mitsui Trust & Banking Co. Ltd.
Allied Irish Banks, plc	CIBC World Markets
Alpha Credit Bank	Citigroup
American Express Company	Commerce International Merchant Bankers Berhad
American International Group, Inc.	Commercial Bank of Greece
AmMerchant Bank Bhd.	Commerzbank AG
Aozora Bank	Commonwealth Bank of Australia
Australia and New Zealand Banking Group, Ltd.	Confederacion Espanola de Caja de Ahorros
Baden-Wuerttembergische Bank AG	Coral Energy, L.P.
Banca Akros Spa	Credit Agricole Indosuez
Banca del Gottardo	Credit Industriel et Commercial (CIC)
Banca di Napoli	Credit Lyonnais
Banca d'Intermediazione Mobiliare IMI S.p.A.	Credit Suisse First Boston International
Banca Intesa S.p.A.	Daiwa Securities SMBC Co. Ltd.
Banca Monte Dei Paschi Di Siena SpA	Daiwa Securities Trust and Banking (Europe) Plc
Banca Nazionale del Lavoro	Danske Bank A/S
Banco Bilbao Vizcaya Argentaria, S.A.	DBS Bank (The Development Bank of Singapore Ltd)
BANCO BPI, S.A.	Den Norske Bank ASA (DnB)
Banco Comercial Portugues S.A.	Depfa-Bank Europe plc
Banco Espanol de Credito, S.A. (BANESTO)	Deutsche Bank AG
Banco Espirito Santo e Comercial de Lisboa, S.A.	Dexia Bank Belgium S.A.
Banco Itau S/A	Dresdner Bank AG
Bank Austria AG	Dynegy Inc.
Bank Brussels Lambert	DZ Bank AG
Bank Hapoalim B.M.	<i>EDF Trading Limited</i>
Bank Julius Baer & Co. Ltd.	EFG Eurobank S.A.
Bank Labouchere N.V.	El Paso Energy Corporation
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CONFERENCES

2002 ISDA Conferences

JANUARY

New York	Operations Training Course	January 16
New York	Understanding The 1992 ISDA Master Agreement	January 23

FEBRUARY

London	Understanding The 1992 ISDA Master Agreement	February 28
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MARCH

Singapore	Documenting and Confirming Credit & Equity Derivatives Transactions	March 6
London	Rescheduled Operations Training Course	March 12 - 13

APRIL

Berlin	ISDA'S 17 ANNUAL GENERAL MEETING	April 16 - 19
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MAY

London	Documenting and Confirming Credit Derivatives Transactions	May 8
London	Understanding Collateral Arrangements and the ISDA Credit Support Documents	May 9
New York	Documenting and Confirming Credit Derivative Transactions	May 15
New York	Understanding Collateral Arrangements and the ISDA Credit Support Documents	May 16

JUNE

New York	Understanding the 1992 ISDA Master Agreements	June 6
Milan	Understanding Collateral Arrangements and the ISDA Credit Support Documents	June 26

JULY

Seoul	Fundamentals of ISDA Documentation	July 9
Toronto	ISDA Canadian Conference	July 10
Tokyo	Credit Derivatives: Documentation and Market Issues	July 11

AUGUST

Brazil:	Fundamentals of ISDA Documentation	August 6
Johannesburg	South Africa Conference, <i>Update on New 2002 ISDA Documentation Projects</i>	August 21

SEPTEMBER

London	ISDA Member Update	September 18
London	Understanding the 1992 ISDA Master Agreements	September 19
New York	ISDA Member Update	September 25

OCTOBER

Chicago	ISDA Documentation Conference	October 1
New York	Operations Training Course	October 23 - 24
Sydney	ISDA Documentation in 2002	October 24
Singapore	ISDA Update	October 28
Bangkok	Fundamentals of ISDA Documentation	October 30

NOVEMBER

London	Documenting and Confirming Credit Derivatives Transactions	November 6
London	Understanding Collateral Arrangements and the ISDA Credit Support Documents	November 7
New York	Documenting and Confirming Credit Derivatives Transactions	November 13
New York	Understanding Collateral Arrangements and the ISDA Credit Support Documents	November 14
New York	2002 ISDA FpML Conference	November 19

DECEMBER

Hong Kong	Credit Risk Management and Credit Derivatives	December 3
London	ISDA Energy and Developing Products Conference	December 12
London	2002 ISDA FpML Conference	December 13

2003 ISDA CONFERENCE SCHEDULE
January 2003 – March 2003

JANUARY - NO CONFERENCES SCHEDULED

FEBRUARY

New York	Fundamentals of Derivatives	February 10
New York	Understanding the New ISDA Documentation Conference	February 11
Toronto	Fundamentals of Derivatives	February 12
Toronto	Understanding the New ISDA Documentation Conference	February 13
London	Fundamentals of Derivatives	February 24
London:	Understanding the New ISDA Documentation Conference	February 25

Amsterdam	Understanding the New ISDA Documentation Conference	February 26
Frankfurt	Fundamentals of Derivatives	February 26
Frankfurt	Understanding the New ISDA Documentation Conference	February 27
Paris	Understanding the New ISDA Documentation Conference	February 28

MARCH

Charlotte	Fundamentals of Derivatives	March 4
Charlotte	Understanding the New ISDA Documentation Conference	March 5
New York	Understanding the New ISDA Documentation Conference	March 11
London	Operations Training Course (two day conference)	March 11
Houston	Fundamentals of Derivatives	March 25
Houston	ISDA Energy and Developing Products Conference	March 26
