ISDA Washington Policy Conference 2017
Opening Remarks – Scott O'Malia, ISDA CEO
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Good morning, and welcome to our Washington public policy conference. Today, we'll reflect on the changes that have occurred over the 10 years since the financial crisis, analyze how the various post-crisis reforms have affected our markets, and consider the work that still needs to be done.

This is an ideal time to discuss these issues. The US Treasury is expected to publish the second part of its review of US financial markets regulation shortly. This follows its first paper in June, which focused on measures to support market liquidity and lending. The CFTC is also reviewing its rules through Project KISS, with the objective of removing unnecessary complexity and duplication.

These are both extremely important initiatives, and I look forward to hearing the insights of our morning keynote speaker, Craig Phillips, Counselor to the Secretary at the US Treasury, and our afternoon keynote, CFTC Chairman Chris Giancarlo.

I would also like to take this opportunity to give a special thanks to Covington & Burling, and to Steven Humenik in particular, who has graciously provided this venue and agreed to host the reception at the end of the day.

Over the course of this conference, we will assess the significant amount of work that has been done to make the financial system safer, more transparent and resilient. We will also consider how the framework can be further enhanced to ensure the thousands of companies that use derivatives to hedge their risk can continue to access this market efficiently.

In my remarks this morning, I will address three key issues. First, I'll look at the progress made to reform the derivatives market, and argue that now is the time to take a long hard look at the rules and see where we can make them more effective and less costly while retaining the protections they provide. Second, I want to highlight the importance of cross-border recognition. Third, I'd like to address the necessity of improving the resilience of CCPs, as well as establishing unambiguous and predictable recovery and resolution strategies for these institutions.

Progress Made in Reform

The Dodd-Frank Act was virtually unprecedented in its scope, and has brought significant change to the market.

To emphasize the scale of the improvement to systemic stability, let's look at one specific policy area – capital. Since the crisis, the largest global banks have raised over $1.5 trillion in new capital. The size of that number can make your head spin, so let's put it in context: $1.5 trillion is roughly the GDP of Canada, the 10th largest economy in the world.

New rules have also been introduced that require all non-cleared trades to be backed by high-quality collateral. Our latest margin survey published today quantifies the impact of these rules. As of March this year, the largest dealer banks held nearly $1 trillion in collateral on their non-cleared trades. These requirements are being phased in for other derivatives users too, which goes a long way to mitigating counterparty credit risk and reducing the risk of losses.

But given these changes, and the amounts involved, it makes sense that we now take the time to fully assess whether the capital and margin framework is appropriately calibrated and risk sensitive.

Elsewhere, more and more standardized trades are being cleared through CCPs – 88.5% of interest rate swap traded notional in the second quarter of this year was cleared. Today, the market is clearing far beyond what is mandated, including non-deliverable forwards and inflation swaps.

But given this increase in clearing volumes, it has become vitally important that a comprehensive mechanism for CCP resilience, recovery and resolution is put in place. I will come back to this point.

The Case for Review

It's clear that a great deal has been achieved to help make the financial system safer and more resilient. But it's equally clear we should strive to ensure the rules are appropriate, and complexity and duplication within the framework are eliminated. This unnecessarily increases the cost and compliance challenges for derivatives users. These costs impact liquidity and risk management, so it's important we get the balance correct.

The recent Treasury paper has highlighted areas where specific, targeted improvements of the rules will result in reduced cost and operational complexity, without undermining safety and soundness. In a few moments, we will hear from Craig Phillips, who is playing a key role inn developing the Treasury reports.

The first Treasury paper, for instance, set out several sensible changes aimed at tailoring regulatory and capital requirements to reflect the size and complexity of financial institutions and supporting market liquidity, investment and lending in the US economy. Among the recommendations is a proposal for domestic implementation of the Fundamental Review of the Trading Book and the net stable funding ratio to be delayed until those measures are assessed and appropriately calibrated.

We agree with the overall objectives of the Treasury review, and believe the capital framework should:

1. Not cause a significant increase in capital levels, as directed by the G-20.
2. Be appropriate, risk sensitive and consistent. To that end, regulators should conduct a comprehensive impact study before all the rules take effect.
3. Be harmonized on a cross-border basis as far as possible to avoid global inconsistency.
4. Be simplified to reduce operational complexity.

The first Treasury letter also highlights the Volcker rule as imposing undue complexity and compliance burdens on firms – an observation echoed by former Fed governor Tarullo in his departing speech. We agree there is an opportunity to simplify this requirement to ensure it does not impede capital markets efficiency.

Making the rules less complicated and more risk appropriate is a core focus of the CFTC's Project KISS initiative. Given the haste with which the Dodd-Frank rules were developed, it is important to undertake a review to see what has been successful and what hasn't.

As it stands, there are many examples of complexity and duplication in the regulatory framework. Much of this arises from having separate CFTC and SEC rules for swaps and security based swaps. There are also areas where US and international rules are in direct conflict. This needs to be addressed. Additionally, the cost of the rules – in particular, the margin application to end users and the margin period of risk – should be reexamined.

Project KISS provides the opportunity to address unnecessary complexity and costs in the financial system.

Later this afternoon, Chairman Giancarlo will address this audience and explain his objectives.

Cross-border Harmonization

Derivatives markets are global. This feature gives companies the ability to efficiently and cost-effectively manage their currency, interest rate, credit, equity and commodity exposures. For this to function effectively, regulators must coordinate to ensure the various sets of rules work on a cross-border basis.

To be effective, regulatory harmonization must be executed in both word and deed. It's not enough for regulators to say their rules are comparable – they must follow through to recognize comparable regimes. Without recognition, firms are forced to comply jurisdiction by jurisdiction.

Currently, the market is waiting to see if US and EU regulators can find common ground on trade execution prior to the implementation of the EU's MIFID II regime in January. A failure to do so would reinforce the fragmentation of derivatives markets and damage cross-border trading flows between the US and Europe. Last year, we published a paper on the similarities between the US and EU trade execution regimes. We believe this provides a clear roadmap to recognition and substituted compliance.

I'd like to take this opportunity to highlight the work by CFTC Chairman Giancarlo in this area, as he has been a consistent proponent of greater trans-Atlantic harmonization. He has just returned from a multi-stop whirlwind tour of Europe and can update you on his observations.

Today, we published a paper that argues the appropriate test of a cross-border framework should be risk-based. This framework is aligned with the objectives of the G-20 and is consistent with the intent of Dodd-Frank. We propose to focus comparability assessments only on those rules that relate to risk – for example, capital and margin requirements for swap dealers, the alignment of US and non-US clearing mandates, and regulatory reporting of swaps.

CCP Safety and Soundness

Earlier, I mentioned the largest global banks have increased the amount of capital on their balance sheets by $1.5 trillion. This added protection doesn't just help banks – it also adds to the safety and soundness of clearing. Clearing is a foundational part of the risk management tools deployed to improve safety and soundness of the derivatives market. We can't ignore the fact that a CCP concentrates that risk as well.

The failure of a clearing house is exceptionally unlikely. However, these entities are systemically significant institutions, and regulators across the world need to fully implement mechanisms to recover, and potentially resolve, a failing CCP. To guarantee contractual and operational certainty, regulators need to continue working together to establish clear and transparent processes for recovery and resolution that work on a cross-border basis.

Today, we have published a series of recommendations on the appropriate next steps to protect against a CCP failure, but also on the steps needed to recover and potentially resolve a CCP. Additionally, we need to keep an eye on the cost of clearing to ensure end users aren't priced out.

To some extent, this important issue has recently been over-shadowed by debate on CCP location following the UK's Brexit vote. The question of whether a national regulator should impose a location requirement on a CCP is clearly controversial and would increase costs and fracture market liquidity. For our part, we think regulators should not be distracted from the importance of establishing globally consistent resilience, recovery and resolution strategies for CCPs. This is critical to ensuring the continued safety and efficiency of the cleared derivatives markets.

Conclusion

The progress made since the crisis is extremely impressive and must be preserved. Higher capital standards, clearing, margining and reporting have made our industry safer and more transparent.

The focus should now be on strengthening the reforms by highlighting areas where they could be more efficient and less burdensome for end users. That includes getting results on cross-border recognition and substituted compliance. Market participants can't easily comply with two sets of rules – and it's unnecessary if they meet the same ends. We need a reliable and predictable recognition regime going forward. I believe our whitepaper sets out a credible vision for how that framework should look, not only for the US, but for other G-20 countries as well.

We also need to move forward with the regulatory work to ensure we focus on the safety and soundness of CCP operations and get better clarity on the application of resources in both a recovery and resolution.

Finally, and most importantly, we are encouraged by the efforts of the Treasury and the CFTC to identify areas where targeted amendments to specific aspects of the rules will make it easier for market participants to access derivatives and hedge risk. We believe many requirements are too complex and costly, especially for non-systemic entities that access these markets to manage risk and raise capital. Our economies will be stronger if we get this balance correct.

We will have numerous panels with market and regulatory experts who will discuss all of these important topics in much greater detail. Thank you for coming and I hope you enjoy the day.

Thank you.