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ISDA Regulators and Industry Forum
Monday, November 13, 2017: 9.00am – 9.10am
Welcoming remarks – Scott O'Malia, ISDA CEO

Good morning, and welcome to our Singapore derivatives forum. Our event today brings together regulators and industry participants from across the globe to discuss the substantial progress made in regulatory reform, and the impact on Asia-Pacific.

I'm very grateful to the Monetary Authority of Singapore and Singapore Academy of Law for their help and support in organizing this event, and we'll shortly hear from Mr. Ong Chong Tee, MAS deputy managing director, financial supervision, who will set the scene for the conference. We'll then hear an overseas perspective from CFTC chairman Giancarlo. I'm very much looking forward to hearing the thoughts of both of our distinguished speakers.

In fact, the global line-up of regulatory and industry speakers here today neatly reflects the global nature of the derivatives market. As we saw in the video we watched a moment ago, the derivatives market exists to reduce risk and provide greater economic certainty for companies across the world. These companies have long benefited from being able to tap into a global derivatives liquidity pool, enabling them to choose from a long list of global counterparties and hedge at the most competitive prices. It's vital we're able to retain these benefits, and not allow that global liquidity pool to fragment into small, regional-based puddles.

Fragmentation would result in reduced choice and higher costs, and could lead to more volatile, brittle markets. That would make it more challenging for end users to effectively manage their risks, particularly in stressed markets.

Cross-border harmonization has long been a key area of focus for ISDA, and it's an issue that is fundamental in Asia-Pacific given the variety of currencies, the role played by global dealers and the different regulatory regimes. Fortunately, there's been recent progress on this front. In its latest report on the US regulatory framework, the US Treasury highlighted rule harmonization as a vital part of efforts to reduce the compliance burden for derivatives users. Our keynote speaker, Chairman Giancarlo, has also consistently raised cross-border harmonization as an important issue that needs to be addressed.

Just last month, the CFTC and EC announced comparability determinations on their margin rules for non-cleared derivatives, as well as a commitment to trading equivalence – demonstrating that an outcomes-based approach to substituted compliance and equivalence can be achieved. This is very positive, and an important step in efforts to ensure robust and liquid global markets.

But while harmonization is important, we also recognize that each jurisdiction is unique. The laws and regulations in one country may be different to those of another. The nature of the banking sector, lending and capital markets may vary. Trading practices, liquidity and product availability might differ.

Just look at Asia-Pacific. The region as a whole is growing faster than the global average – Asia-Pacific real GDP is projected by the IMF to grow at 5.5% in 2018, versus 3.7% globally and 2.3% in the US. As growth markets, capital inflows from overseas remain strong and foreign exchange reserves have grown. The IMF estimates that net capital inflows into emerging markets totaled $115 billion in the first half of 2017.

It's should come as no surprise that the region's derivatives markets also have their own characteristics, reflecting the economic and geographic realities. While interest rate derivatives comprise about 77% of the total derivatives market globally with FX accounting for around 14%, the reverse is true in Asia. FX derivatives overwhelmingly dominate as firms focus on managing the risks associated with their domestic currencies.

This is reflected in the latest triennial survey from the BIS. Sales desks based in Asia-Pacific accounted for 20% of FX average daily turnover in April 2016, with Singapore alone accounting for 7.9%. Chinese renminbi, Singapore dollar, Hong Kong dollar and Korean won are among the region's currencies to experience increased turnover compared with the last triennial survey.

In interest rate derivatives, however, the region's sales desks accounted for a much smaller share of average daily turnover – just 7.6%, with Singapore representing a 1.9% share.

This obviously has a number of implications. While clearing volumes have risen globally in recent years as a result of regulatory mandates and in response to capital and operational efficiencies, clearing activity is primarily concentrated in interest rate and credit derivatives. According to the latest BIS semiannual derivatives figures, 77% of interest rate derivatives and 51% of credit default swap notional outstanding was cleared at the end of June 2017.

While clearing services have emerged for certain FX products – notably, non-deliverable forwards – clearing volumes are still relatively low, reflecting the fact that clearing isn't available for all FX products and currencies. According to the BIS, approximately 1.5% of FX derivatives notional outstanding is cleared.

The means, unlike the US and Europe, a large portion of derivatives in the Asia-Pacific region would be non-cleared – and, what's more, currently non-clearable.

So, what's the answer? How do we develop and implement a global regulatory framework that allows for effective cross-border trading, but also recognizes that each jurisdiction is unique? How do we ensure that counterparties that trade across borders are not exposed to excessive compliance burdens and costs, simply because their markets are different?

At ISDA, we've been working hard to develop solutions to this issue.

First, we think a large part of the answer is to revamp the process for substituted compliance and equivalence determinations. In September, 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 derivatives reform legislation. We propose to focus comparability assessments only on those rules that relate to risk – for example, capital and margin requirements, clearing mandates and regulatory reporting of derivatives.

By taking a risk-based approach to determine whether one set of rules is comparable to another set, it avoids an unnecessary, granular rule-by-rule analysis that takes a lot of time and can ultimately result in failure. Regulators have to accept that overseas rules do not have to be identical in order to achieve similar outcomes.

Again, I'd like to recognize the work already done by Chairman Giancarlo in this area, and I look forward to hearing his thoughts on how we approach cross-border comparability determinations.

But along with the framework for comparability, we also need to take a clear-eyed look at the regulatory framework to determine what's working well and what could be made to work better. In particular, we need to consider where there is scope for greater harmonization and more appropriate calibration.

Regulators in the US and Europe are already reviewing their derivatives rules with the objective of making the framework simpler and removing unnecessary compliance burdens, while ensuring the safety and soundness of the financial system is maintained. We welcome initiatives like the CFTC's Project KISS, the US Treasury's review of financial regulation, and the European Commission's review of EMIR.

We've fed into all three initiatives with our recommendations.

For instance, we strongly believe the rules should be risk-appropriate. In our view, the 10-day margin period of risk for non-cleared products versus five days for cleared is arbitrary and should be viewed through the lens of risk and liquidity. A blanket 10-day requirement for all non-cleared derivatives does not recognize that certain non-cleared products, currencies and tenors are highly liquid. We're glad the US Treasury has also flagged this issue in its second paper, published last month.

A more risk-appropriate approach in setting this time horizon could help reduce hedging and trading costs for derivatives users in markets like Asia, where a large portion of activity is currently not clearable.

Sticking with margin requirements, we think settlement timing also needs to be reviewed – again, something recognized by the US Treasury. Settlement time is fixed at T+1 in the US, unlike in many other jurisdictions where more time is allowed. This poses particular challenges for those firms in Asian time zones when trading with US dealers.

In the push to greater harmonization, a key component is already in place – the ISDA SIMM. By developing a global standard methodology for initial margin calculation that everyone can use, the potential for each firm to develop its own model – and the inevitable disputes this would cause – has been reduced. As more firms in more jurisdictions fall into scope of the initial margin rules, it's important that regulators coordinate in order to maintain the global consistency of the model. ISDA is playing a key role here by overseeing regular calibrations and monitoring of the parameters.

Turning to clearing. As I showed earlier in my remarks, each jurisdiction can differ in terms of trading and clearing activity. However, these regional differences should not distract regulators from working together on the critical task of establishing a clear and transparent recovery and resolution framework that works on a cross-border basis.

In September, we 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. This issue is critical to ensuring the continued safety and efficiency of the cleared derivatives markets.

I'd like to finish my remarks by briefly touching on technology – a particularly topical subject given the start of the Singapore FinTech Festival this week.

It feels like we're on the cusp of a big change in the derivatives market. Existing infrastructure is complex, disjointed and reliant on manual intervention, but new technologies like distributed ledger and smart contracts offer the potential to improve automation, increase efficiency and reduce complexity and costs. Singapore is emerging as a hub for these types of technologies, supported by the MAS FinTech regulatory sandbox.

However, these technologies must be built on common standards. A world in which each technology platform has its own unique standards and representations would be little better than the disjointed infrastructure we have today.

This is where ISDA is stepping in. We have a 30-year history of driving standardization in derivatives markets – from the launch of the ISDA Master Agreement to our advocacy on the benefits of close-out netting across the globe. We're now working to develop a common representation of trade events that accurately describes the very fabric of the market, in order to realize the full potential of these technologies.

Called the ISDA Common Domain Model, our intention is to create a comprehensive standard digital blueprint for how derivatives are traded and managed right across the lifecycle of a trade. This will enhance consistency and interoperability across firms and platforms, providing a bedrock of standards upon which new technologies can be applied.

Last month, we published a conceptual version of the CDM, and we recently issued a request for quotations for vendors to build a digital version. The next step will be to work with technology vendors and industry participants to develop proof of concepts. We've already got a wide universe of buy- and sell-side participants, technology platforms and lawyers involved in this process. But we'd like your feedback too.

Please get involved. We all have to work together to ensure our industry continues to be fit for purpose for the 21st century.

Thank you