ISDA Industry and Regulators Forum – Singapore
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Opening Remarks
Scott O'Malia, ISDA Chief Executive

Good morning.

Welcome to the ISDA Industry and Regulators Forum. This is the second time we've held this event in Singapore, and I'd like to thank the Monetary Authority of Singapore for their continued help and support in organizing this forum.

Our event today brings together senior regulators from ASIC, the CFTC and the MAS to discuss key issues affecting the derivatives markets. But before we turn to our keynote speaker, let me ask you an important question: are you all looking forward to the F1 this weekend?

I am – this will be my first. To be honest, I don't know much about motor racing – I'm more of a football fan. The only contact I've had with racing up until now has been through my kids watching and re-watching the Pixar movie Cars when they were young.

But I have picked up a few things. The start of the race is fast and furious – everybody flies off the grid like a bullet, but the outcome is uncertain. Then there are the twists and turns to negotiate, all the while trying not to spin off track. Throughout the race, the drivers look to make incremental advances to position themselves for the all-important final lap and finish line.

The regulatory reform agenda can be viewed in a similar way. There was a period of frenetic activity after the G-20 published its derivatives reform objectives in 2009, as each jurisdiction moved fast to develop rules. A lot of progress has been made, but there have been a number of twists and turns along the way, especially in building an effective cross-border framework. It now looks like we could get to a good end point, but there are still some significant obstacles to negotiate in this final lap – notably Brexit.

I'm going to touch upon each of those issues in my remarks today. First, I'll briefly summarize the very significant progress that has been made in reforming derivatives markets. Second, I'll cover the challenges we face in achieving a robust cross-border framework. Finally, I'll touch upon Brexit, and the issues we think need to be resolved.

Progress in Reform

It's easy to forget just how far we've come and how much progress has been made. If we look back at the commitments made by the G-20 nations in 2009 and 2011, all are either in place, or in the process of being phased in.

- **Clearing of standardized derivatives**: Approximately 75% of total interest rate derivatives notional outstanding is now cleared. A clearing mandate is in place in Australia, and a clearing requirement will shortly come into force in Singapore for Singapore dollar and US dollar fixed-floating interest rate swaps.
- **Reporting of OTC derivatives**: Virtually all financial centers have mandates in place requiring derivatives trades to be reported to regulators.
- **Capital**: Since 2009, the largest global banks have added about €1.5 trillion of Tier 1 capital to their balance sheets. Further measures finalized by the Basel Committee in December 2017 will result in an estimated €85.7 billion in additional capital.
- **Trading**: Trade execution rules have been introduced in several jurisdictions, including the US and EU, and are under consideration in others, including Singapore.
- **Margin**: Variation margin requirements for non-cleared derivatives have been in place since September 2017, and initial margin requirements are being phased in. According to recent ISDA research, the top 20 derivatives dealers held $130.6 billion in initial margin and $893.7 billion in variation margin on their non-cleared derivatives trades at the end of 2017.

A lot of work has gone into complying with these commitments in the US, EU, Japan and elsewhere. In this region, both ASIC and the MAS have been thoughtful advocates for reform, and pragmatic in their adoption of the G-20 objectives, including clearing, reporting, margining and capital reform.

The resulting national rules are comparable – they all achieve the same objectives. But they are not identical. Which brings me to the second part of my remarks – the importance of a robust cross-border framework.

Cross-border framework

Despite all the progress, we haven't yet been able to take the final step – to create a cross-border regulatory framework that allows firms to trade efficiently across borders.

Now, it's important that we push for greater consistency in the rules where appropriate. The reporting framework is a case in point. In this area, I'd like to commend the work of ASIC and the MAS in setting the bar high on data sharing and cooperation.

However, we must recognize that national rule sets will never be exactly the same – national regulators need to take the characteristics of their local markets and existing legal regimes into account. We therefore need a cross-border framework that allows for variations in the detail, but recognizes overseas rules that are comparable in outcomes. There must be some acceptance that compliance with two sets of rules – both home and host – is extraordinarily difficult and costly.

This is the reality for many market participants because derivatives markets are global. This market developed to facilitate the transfer of capital from where it is to where it is needed. It gives companies the ability to cost-effectively raise financing and manage their exposures, as this video – the latest in our educational whiteboard animation series – explains.

Watch Video

Given the realities of our market structure, you can see the importance of an effective cross-border framework. Without cross-border recognition, counterparties would need to have multiple and, in most cases, duplicative compliance systems in place to meet the various rules simultaneously. Unless addressed, the lack of regulatory cooperation will increase the complexity of cross-border trading, which will ultimately fragment market liquidity and raise costs.

This is precisely why ISDA has consistently advocated for a risk-based solution to the cross-border puzzle. When assessing foreign regulatory regimes for comparability, regulators should focus *only* on whether the regime has sufficient mechanisms in place to address or mitigate systemic risk.

The process must start and end with risk. For those activities that are not risk related – such as trading, business conduct and public reporting – we believe deference should be given. While these non-risk rules achieve important policy goals, such as ensuring customer protection, improving market structure and preventing market abuses, they are more appropriately left within the remit of local regulators, which tailor the requirements to suit the characteristics of their local markets.

This was not the approach taken by the US, specifically the CFTC, back in 2013, which essentially exported US rules to every other country. As a CFTC commissioner at that time, I opposed this overtly extraterritorial policy.

Fortunately, CFTC Chairman Giancarlo has recognized the difficulty this has caused, and is taking a different approach. At the end of last year, the CFTC and the European Commission reached agreement on trading venue equivalence – an important step in efforts to ensure robust and liquid global markets. Then, just last week, Chairman Giancarlo announced his plans to publish a new whitepaper dubbed Cross-border Swaps Regulatory Version 2.0.

This paper will attempt to redefine the application of US rules on a cross-border basis. We agree with Chairman Giancarlo that the current framework is over-expansive, unduly complex and operationally impractical.

By proposing to focus primarily on those reforms intended to tackle cross-border systemic risk when making comparability determinations, and allowing greater flexibility and jurisdictional tailoring for non-risk-based reforms meant to address market structure and trading practices, the approach is more consistent with Congressional intent to focus on activities that pose a "direct and significant" risk to the US. The proposal to exercise regulatory deference to those jurisdictions like Australia and Singapore that have implemented broadly comparable rules should also help reduce the potential for cross-border fragmentation.

If successfully applied, the proposed approach provides a more efficient and consistent way of regulating derivatives markets on a global basis. While the industry will welcome such a

proposal, the complexity of the derivatives markets makes it critically important that the new framework does not disadvantage any class or group of market participants. We look forward to reviewing the paper when it is published, and engaging with the CFTC on this very important issue.

I'd like to commend Chairman Giancarlo for the work he has done in this area, alongside other CFTC initiatives like Swaps Regulation Version 2.0, which is aimed at improving the US regulatory framework, removing inefficiencies and supporting economic growth. One of the areas of focus is a revision to the SEF framework, and I'm looking forward to hearing Chairman Giancarlo's remarks on how this and other initiatives are progressing.

However, as the rules adapt – whether in the US, Europe or elsewhere – it does pose some interesting questions. For one thing, what will it mean for other markets, other rules and existing substituted compliance and equivalence determinations?

What does it mean for Australia and Singapore, which have tended to be 'fast followers' of the US and EU in developing their rules, with an eye to achieving substituted compliance and equivalence determinations? For example, Singapore released its own trade execution rules for consultation in February. Will it need to rethink its approach once the US adapts its SEF rules to ensure it receives a substituted compliance determination? By doing so, will it reduce its chances of an agreement with the EU?

Under a risk-based equivalence framework, it shouldn't make a difference. So long as those rules that relate to risk – capital and margin requirements, clearing mandates and regulatory reporting – remain comparable, other differences shouldn't stand in the way of equivalence.

There is, however, a potential obstacle looming on the horizon – Brexit.

Brexit

As it stands, it's not clear what the post-Brexit landscape will look like, or even whether the UK and EU will agree a withdrawal agreement and transition period before March 29, 2019. Barring some alternative arrangement on its status, however, the UK will become a third country under EU law at the point it leaves the EU.

Again, depending on the terms of the withdrawal, the UK might opt to seek equivalence determinations from the EU. This will be a real acid test for the cross-border framework. At the point it leaves the EU, the UK regulatory framework will be identical to the EU's. Anything other than a quick equivalence determination would therefore be a blow to cross-border harmonization – not just for the UK, but to all third countries trying to access the EU. Is the new standard going to be identical rules? Given the differences in the rules today, this seems impossible.

Even a short hiatus between the UK becoming a third country and being deemed equivalent by the EU could cause disruption. For example, EU 27 counterparties would be unable to act as clearing members at UK CCPs at the point the UK becomes a third country, and neither they nor

their clients would be able to clear products subject to the EU clearing mandate until UK CCPs are recognized by the EU.

We think many of the potential challenges should be addressed through the withdrawal agreement, or through legislative or regulatory action by the UK and the EU. However, we would also urge European regulators to put backstop arrangements in place – for example, a temporary permissions and recognition regime, similar to what UK authorities have said they will implement. This will enable firms in the EU 27 and UK to carry on doing business until a permanent authorization or equivalence determination is achieved, minimizing disruption to global markets in a hard Brexit scenario.

Finally, we need to understand what policy-makers mean when they say they would like an enhanced equivalency agreement for the UK. What would this mean for the UK, and how will other countries be treated?

Conclusion

On the one hand, I'm deeply discouraged by the trajectory of the Brexit negotiations and the possibility of a rigid rules-based system. On the other hand, we have a fresh approach proposed by Chairman Giancarlo – one that is outcomes-based and respects jurisdictional differences. As the Chinese saying goes: "May you live in interesting times". Frankly, it doesn't get any more interesting than this.

To come back to the F1 analogy – I'm not sure how this race will end, but there's a lot riding on the outcome.

Thank you.