ISDA Safe, Efficient Markets

International Swaps and Derivatives Association
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Opening Remarks
Scott O'Malia
8.45am April 22, 2015

Good morning everyone. Welcome to Montreal. And welcome to ISDA's Annual General Meeting. Roughly 850 of you have made the trip north to be here for the next two days. I'd just like to take this opportunity to thank all of you, our speakers, our exhibitors and our sponsors for coming.

As many of you will know, this is ISDA's 30th AGM. Thirty years ago, a small group of derivatives dealers – much, much smaller than the 850 people here today – gathered together in New York to discuss how to develop and improve this small, but promising market.

Since then, ISDA has continually played a leading role in the development of the derivatives market – from the early work in developing standard derivatives contract terms, which laid the foundations for the growth of the market, through to more recent efforts to develop an industry standard model for calculating initial margin requirements.

As many of you will also probably know, this AGM is my first as ISDA chief executive. I joined ISDA last year, having previously been a commissioner at the CFTC. For me, it was the reputation that ISDA has earned over the past three decades for its detailed, technical work and for getting things done that attracted me to this organization. To describe it in a word: relevance.

I was at the CFTC at a time when the derivatives market was being overhauled and new rules were being developed and implemented at an incredible pace. This included the rules for mandatory clearing, for trade reporting and for SEF trading, among others.

Serving as Chairman of the Technology Advisory Committee, I had a front-row seat to see the massive investment in technology to integrate trading, clearing, reporting and compression. Throughout my time there, my primary focus was on trying to make sure those rules worked as effectively as possible.

So, with the bulk of the rule-making complete and attention very much turning to implementation, ISDA seemed the perfect place for me to continue to have a voice in how the rules can be implemented most effectively. The qualities that have made the association successful over the past 30 years – an ability to work at a detailed, technical level, its sharp legal work and its global perspective – were what made it stand out and what made it attractive to me.

Having said all that, it's clear that ISDA can't stand still and rely on its 30-year reputation. We need to make sure we continue to adapt and to evolve, to add to our core areas of strength, and to ensure ISDA remains relevant and is positioned for continued success over the next 30 years.

I would like to share with you three topics that I have been focusing on in my first year, where ISDA has inherent strength and has the potential to play a very important role.

First, I want to discuss cross-border rule harmonization. Building on our global footprint and leveraging our technical skills, ISDA is ready to work with regulators to advocate for rules that unite liquidity and markets, rather than divide them.

Second, fixing broken rules and advocating for alternatives that aren't just talking points, but are technically sound and provide specific solutions.

Third is serving our members. ISDA is a member-driven organization, and we need to continue to identify new ways to enhance our offering. I'll share with you some of my thoughts on how we are accomplishing this.

Let me turn first to cross-border rules and the importance of establishing a globally consistent framework. Beginning in Pittsburgh in 2009 and continuing through until today, cross-border harmonization has been a consistent objective of regulators in every jurisdiction. However, achieving that goal has been a challenge.

This has been an issue since the dawn of the derivatives markets more than 30 years ago. Derivatives markets are, and always have been, global markets.

But this issue has become increasingly important today with the introduction of clearing, trading and reporting rules.

Market participants are now increasingly subject to duplicative and inconsistent requirements because regulators didn't fully consider how their rules would align with other jurisdictions. That's a problem.

In order to resolve this, there has to be an effective process in place for recognizing and deferring to comparable regulatory regimes, with substituted-compliance determinations based on broad, intended outcomes. There also needs to be a concerted effort to make the rules and standards more globally consistent. This is something ISDA has been contributing to, both with research and proposed solutions. I'll come on to some of our specific proposals in a minute.

But there are other, related issues that are also relevant for members, where ISDA has also been active.

At the end of last year, we ran an extensive member survey and asked participants to identify the issues that will have the most impact on the derivatives markets over the next three years. The cross-border issue kept coming up again and again, along with two other topics: margin rules for non-cleared derivatives; and bank capital.

I've already mentioned the cross-border issue. I'll briefly touch on the other two.

First, the margin rules. ISDA has long been an advocate for effective, efficient and safe collateralization of derivatives trades. That dates back to the development of the ISDA Credit Support Annex, a standard agreement that governs the exchange of collateral between counterparties.

As such, it’s no surprise that ISDA is leading industry efforts to prepare for the changes that will need to be made to infrastructure, documentation and technology as a result of the new requirements.

Central to that initiative is the development of a standard initial margin model, or ISDA SIMM. This will establish a common framework for industry participants to calculate initial margin and reduce the potential for disputes.

ISDA is also leading an initiative to update collateral agreements so they comply with the new requirements in each jurisdiction. That’s absolutely essential if these rules are to be implemented safely and efficiently.

There’s a lot of work that needs to be done. That’s why ISDA was extremely glad that regulators listened to our request for an extension to the implementation date, and gave the industry an additional nine months. However, this will still be a challenge given the fact that final rules have not been published by national authorities. My request is that regulators in the US, Europe and Japan release a globally consistent margining framework by this summer.

To learn more about this key initiative, please join our WGMR panel tomorrow afternoon. We explain the ins-and-outs of the legal framework, collateral requirements and the ISDA SIMM model.

Another key area of concern for our members is establishing a cost-effective, global standard for bank capital.

Again, this has been an issue ISDA has been closely involved in over the past 30 years. For instance, ISDA was instrumental in ensuring that the benefits of netting were recognized in capital rules. Over the years, ISDA has led industry responses to Basel II, Basel 2.5 and Basel III.

But the combined impact of the capital, liquidity and leverage rules that will be rolled out over the next few years has made this a big priority for members.

To some extent, similar cross-border themes emerge. The requirements are developed on a global basis by the Basel Committee. National authorities are then left to implement them locally. In certain areas, the Basel rules have been contentious, leading national authorities to develop their own, unique approaches.

The result is that capital requirements for identical transactions can differ in different jurisdictions. Banks with higher capital charges may well pass those onto end users, creating distortions in the global competitive environment.

We believe capital rules should be globally consistent and risk sensitive. Given the various components of the capital, leverage and liquidity rules – and the fact each component has been developed separately – we also think the cumulative impact of the rules should be closely assessed.

ISDA is currently conducting a number of studies on market impact, including an analysis of liquidity, and an investigation into the cost impact of the Fundamental Review of the Trading Book.

Please joint our capital panel tomorrow to learn more details on how the new prudential requirements are affecting business lines and market liquidity.

Let me now turn to the important job of fixing rules.

On the face of it, this doesn't appear to be a significant request.

At ISDA, we believe we must be specific about the flaws in the rules and the solutions that need to be applied. As part of that, ISDA has published two papers over the past two months: one on solutions to the data rules and the other on trade execution.

In both cases, the US has been first to roll out its rules. Both are more than two years old. The market has tried its best to comply over that time, but the flaws are obvious and are compromising their effectiveness.

The trade reporting rules provide a good example. This is an issue I regularly raised when I was at the CFTC. Regulatory reporting requirements need to be harmonized across borders, so derivatives users report the same type of data in every country. That's not happening at the moment – required trade data can differ significantly from country to country.

ISDA has played a key role in helping to resolve this issue – for example, through the development of the reporting standard FpML and creation of a common product taxonomy. But it's a hugely important issue for our members, and we stand ready to help further develop these standards as necessary.

ISDA also published a paper on data harmonization in March that outlines five principles for fixing the data rules and establishing a more consistent reporting regime. This will increase data utilization by regulators, lower costs and encourage efficiency for the market.

Trade execution is another area that is relevant to our members and in which ISDA has been involved. ISDA is approaching the trade execution requirements in two parts. First, we would like to see modifications to the SEF rules to see more flexibility to encourage end users to access these platforms.

Second, we want to see similar rules in the US, Japan and Europe. The US already has a trade execution regime in place through its SEF rules, while Europe is still in the process of developing its rules through MIFID II.

These differences in timing have caused a fragmentation of liquidity. In short, non-US participants are avoiding trading mandated products with US firms where possible, as this would require them to trade on US-registered SEFs.

The implementation of a European trading mandate in 2017 may go some way to easing the problem. But there are significant differences between the existing SEF framework and the rules proposed by European regulators. In other words, a substituted-compliance determination between the two sets of rules is by no means a given.

Again, ISDA is playing an active part in this area. We've already contributed to the debate by publishing a set of principles for the centralized execution of swaps. We believe that abiding by these principles when developing trade execution rules will increase the likelihood of a substituted-compliance decision.

I'm looking forward to the SEF panel later this morning, in which we'll hear from both market participants and SEFs on how the trade execution regime is progressing.

Finally, let me turn to changes we are making within ISDA to ensure we continue to be relevant and provide the best service for members.

Early on, I recognized we needed to make several key hires to build our expertise in clearing and trading – both strategic areas for us. Leveraging our global footprint, we pulled together our regional public policy teams under a single global head to coordinate and manage regional advocacy efforts and develop a global policy strategy. We are also using this team to increase the breadth and depth of our market research, and to develop more policy papers and surveys. We believe this gives ISDA the best platform to work on behalf of our members.

To improve our member engagement, we are reviewing our working-group structure to ensure we are focused on priority initiatives. We are also implementing a more user-friendly web-based member information console to help our members easily access important information and data.

To sum up, there have been plenty of changes of the past 30 years and further changes are on the horizon.

But some things are just as certain now as they were to those attendees at that first AGM in New York. Banks, asset managers, pension funds, insurance companies and corporate treasurers will always need to hedge their risk. Derivatives are an effective tool to do that. And ISDA will continue to play a key role in ensuring those markets are safe and efficient, whether cleared or non-cleared, SEF-traded or bilateral.

I hope you enjoy our annual meeting and learn from our panels. I look forward to meeting with you and hearing your ideas on how we can continue to make ISDA relevant to your firms and to policy-makers.