Japan Derivatives Forum
November 15, 2022

Opening Remarks
Scott O'Malia, ISDA Chief Executive

Good morning, and welcome to the ISDA Japan Derivatives Forum. Thanks for joining us today, and a big thank you to OSTTRA for supporting the event.

I'm delighted to be back in Tokyo for our first in-person event since 2019. The global pandemic meant we haven't been able to speak face to face until now, but it hasn't stopped ISDA and our more than 1,000 member firms across the globe from achieving a phenomenal amount over the past three years.

For example, we successively negotiated the phaseout of most LIBOR settings and implemented phases five and six of the margin requirements for non-cleared derivatives – both among the most significant challenges the derivatives industry has ever had to face. We've begun to embrace the digital age, with the launch of our first digital definitions and the MyLibrary electronic documentation platform. And we've transformed how banks implement standardized capital models by developing ISDA SA Benchmarking, a tool that allows users to compare their implementation with an industry standard.

In my remarks this morning, I'd like to briefly update you on three new major priorities for ISDA – the growth of crypto derivatives, our digital regulatory reporting (DRR) initiative, and the continuing focus on environmental, social and governance (ESG) issues.

Let me start with crypto.

The recent extreme volatility in this asset class has brought some important questions to the fore. Among the most important is what rights investors have in the event of a bankruptcy of a crypto exchange or wallet provider. At the moment, the answer is not always entirely clear.

This has emphasized the importance of having a clear, consistent contractual framework that spells out the rights and obligations of both parties following a default.

At ISDA, we want to bring the same legal certainty that exists in other derivatives asset classes to the over-the-counter (OTC) crypto derivatives market. Working with members from both the crypto and traditional finance sectors, we're well advanced in producing standard terms for cash-settled forwards and options referencing Bitcoin and Ether.

Until now, institutions have largely traded crypto asset derivatives using amended versions of existing ISDA definitions and templates or using their own bespoke documentation. That not only leads to a lack of standardization – it may mean that certain unique events that occur in the crypto assets market, like forks and airdrops, are not directly covered by the documentation.

Our new standards will reflect the specific characteristics of the crypto market, with the initial set of definitions due to be published before the end of the year. We'll then look to extend that work – for example, by considering the development of collateral documentation for the OTC crypto derivatives market. We'll also consider drafting contractual standards for other product types, including swaps and physically settled transactions.

We're not just focusing on legal and documentation issues – we're also working to ensure a risk-appropriate capital framework. The Basel Committee on Banking Supervision published its second consultation on the prudential treatment of bank exposures to crypto assets earlier this year and plans to finalize its standards before year-end.

The latest consultation makes some important improvements, but we believe the proposed framework remains unnecessarily conservative and would hamper the ability of banks to meet customer demand for intermediation in crypto exposures. We recommended a number of changes in our response, and we will continue to work with regulators to achieve a framework that is risk appropriate.

I'd now like to turn to our DRR initiative.

Regulators around the world are adapting their reporting rules to make them more globally consistent, starting with an initial batch of changes by the US Commodity Futures Trading Commission (CFTC), which will be implemented on December 5. Similar changes are also expected in Europe in 2024, as well as in several jurisdictions across Asia-Pacific.

The revisions to include globally agreed critical data elements will go some way to reducing the inconsistencies that have plagued regulatory reporting for the past decade. But it won't solve the problem by itself. Firms still need to interpret each set of rules and make the relevant changes to their reporting systems – and there's historically been no way to ensure firms are interpreting the rules in the same way, leading to inaccuracies and discrepancies.

Digital reporting can resolve this issue. As part of ISDA's DRR initiative, industry working groups have developed a collective, mutualized interpretation of the relevant CFTC rule amendments, using the Common Domain Model to transform that interpretation into open-source machine-executable code. Firms can then either use that code as the basis of their implementation or to benchmark their own interpretation and check they are on the right track.

I'm pleased to report that BNP Paribas recently implemented and tested the DRR for the CFTC rules in a production-level environment using real data, with a successful submission of data to the Depository Trust & Clearing Corporation's swap data repository – an important step that proves this solution works.

Having completed the work for the CFTC revisions in December, we'll prepare for other amendments that are expected elsewhere. We estimate around 70% of the coded CFTC rules can be transferred directly to the DRR that is being developed for the European rules, while 90% of the combined coded US and European rules could transfer to Asia-Pacific. This means a substantial portion of the coding has now been completed, with only incremental efforts required for the DRR to be applied to other jurisdictions' reporting rules.

This could include reporting rule changes in Japan, due for implementation next year. We're currently discussing with members and regulators to determine if there is appetite to apply the DRR solution here as well.

We think this is a real game changer. Thanks to industry collaboration and a peer-reviewed interpretation of the rules, the DRR will bring much greater efficiency and accuracy to the reporting process.

I'll finish by briefly touching on another key area of focus – climate risk and ESG.

This has become a global priority, with companies and countries around the world committing to reduce their emissions of carbon dioxide to mitigate the impact of climate change.

There are a number of ways firms can achieve this, but voluntary carbon markets are seen by many as a vital tool to allow companies to act on emissions they can't otherwise reduce, and to channel financing to green infrastructure and technologies.

Japan is now testing its own carbon credit trading framework, with the full launch scheduled for April.

As with crypto, robust legal foundations will be critical for the trading of carbon credits. ISDA has already published several papers exploring the key legal and regulatory issues that must be addressed in any contractual terms for the voluntary carbon market, and we're planning to extend this analysis to Japan. We will also shortly launch standard documentation for global trading of physically settled voluntary carbon credit spot, forward and options contracts.

This is a vital step in enabling the safe and efficient trading of carbon credits and comes on top of ISDA's other work in this area. For example, we have published several whitepapers to support the development of standards for sustainability-linked derivatives (SLDs), including analysis on the regulatory implications of these products in Japan. We're now exploring whether to draft standardized terms for documenting SLDs, which will bring greater harmonization and efficiency to this nascent product.

We're also looking closely at the capital treatment of carbon credits and progress by banks to develop scenario analysis to assess the impact of climate risk on their trading books. ISDA recently published a survey on climate risk scenario analysis in conjunction with EY to clarify industry progress to date, as well as highlight the work that still needs to be done. That survey is on our website, and I'd encourage you all to read it.

Crypto, digital reporting and ESG are three big industry priorities that will keep us all busy in the year ahead. ISDA's focus will be the same as it's always been – to develop the legal documentation, standards and mutualized solutions needed for derivatives markets to function safely and efficiently.

Thank you.