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Derivatives Trading Forum: Post-trade Operations, Services & Technology
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Opening Remarks
Scott O'Malia, ISDA Chief Executive

Hello everyone, and welcome to the Derivatives Trading Forum. Thank you for joining us today, and thanks to Quantile for sponsoring the event.

This is the fourth and final conference in a series that has scrutinized derivatives trading through different lenses, including regulation, politics and environmental, social and governance (ESG). Overall, these four events have attracted well over 3,600 registrants, highlighting the depth of interest in the major trends that are driving derivatives trading strategies around the world.

Those who attended the last event on ESG may be interested to learn that ISDA has just published two papers on this topic – one looking at the legal implications of voluntary carbon credits, and another on the regulatory treatment of sustainability-linked derivatives. This is an important and fast-evolving sector, so do keep an eye out for further ISDA papers and events on this issue in 2022.

Today, though, we turn to post-trade operations, services and technology.

The past decade has seen the transformation of the post-trade landscape, driven in part by the Group-of-20 requirements for central clearing, reporting and margining of OTC derivatives. Those reforms are now well entrenched in the market infrastructure, but the journey is far from over.

Jurisdictions around the world are reviewing data reporting regimes with the aim of achieving greater levels of accuracy and consistency in reporting. Meanwhile, the rollout of initial margin (IM) requirements for non-cleared derivatives is now entering its final phase, as a large number of smaller entities prepare to comply with the rules next year.

I'll cover both topics in these remarks.

Reporting

First, reporting.

In some respects, swap data reporting has been one of the most challenging of the post-crisis reforms. In recent years, regulators have recognized the need for greater consistency and accuracy in reporting and have set about reviewing their rules with the aim of adopting globally harmonized data elements. These new reporting rules will come into force in 2022 for the US, and 2023 for the EU and certain Asia-Pacific jurisdictions. Assisting firms in the implementation of the new reporting requirements is a priority for ISDA.

The Commodity Futures Trading Commission (CFTC) is the first regulator to have amended its reporting rules, with the changes due to come into effect in May 2022 – less than six months from now. The amendments incorporate critical data elements agreed by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions into the US swaps reporting framework, as well as changing certain other CFTC-specific data fields.

Complying with rule changes brings its fair share of challenges. Specifically, firms have to interpret the requirements and build the changes into their systems. While the CFTC has adopted the critical data elements, there is still scope for variation in how firms interpret and implement the requirements. The US and EU rules do have considerable overlap in both the content and format of the reporting fields, which offers the opportunity to use a common taxonomy and technology to ensure more cost-effective compliance.

Under our Digital Regulatory Reporting (DRR) initiative, we have been working at pace to model the amended CFTC rules into human-readable, machine-executable code using the Common Domain Model (CDM). The DRR will avoid the inconsistencies that arise when every firm interprets a set of rules independently. It also offers huge savings to firms as they don’t need to dedicate extensive resources to reviewing, designing and building reporting logic from scratch.

The benefits of the DRR extend beyond the initial implementation. If further changes are required in future due to regulatory clarifications, the reporting code can be adjusted centrally and then deployed rapidly and consistently by all firms that use the DRR. Supervisors will also have access to this code, giving them full transparency into how the rules are being applied.

We have started this initiative with a focus on the CFTC rules, but we are also working to digitize the revised EU trade reporting rules under the European Market Infrastructure Regulation (EMIR). We expect a large proportion of the data elements being coded for the CFTC requirements to be fully or partially reused for EMIR. As other jurisdictions incorporate the data elements into their reporting rules, we will extend the DRR to support consistent implementation around the world.

When the reporting rules were first implemented, the industry didn’t have the time or resources to apply a scalable technology solution to support compliance. Ten years on, using the CDM as the common taxonomy, we can now deploy a software solution that will create unprecedented efficiencies and cost savings for firms, generating data that is reliable, consistent and useful to regulators.

ISDA has a working group focused on the DRR, and we welcome firms to join and help develop this critical compliance tool.

Margin

I’ll move now to another important part of the post-trade landscape – initial margin.

We are currently between the final two phases of the implementation of IM requirements for non-cleared derivatives. On September 1, the IM rules extended to hundreds of new counterparties under phase five, and, next September, we expect to see roughly double the number of counterparty relationships come into scope.

Phase five highlighted a number of challenges that smaller entities face when complying with these rules. For example, most of these entities will engage a third-party custodian for receiving collateral as well as onboarding with the tri-party custodians used by their dealers. This involves negotiating account control agreements and fulfilling extensive know-your-customer requirements. Custodial onboarding is a time-consuming and resource-intensive process that must begin as far in advance of the deadline as possible.

As many small firms have their derivatives portfolios managed by multiple asset managers through a separately managed account, the compliance process is dependent on each firm calculating its swaps exposures and disclosing to its asset managers if it expects to breach the threshold for compliance. If these calculations and disclosures are submitted late, it threatens to delay the implementation process.

The overriding lesson we have learned from the first five phases is even more relevant for phase six – early preparation is critical. The good news is that we now have a well-rehearsed playbook for compliance. As well as offering extensive resources to guide firms at each step of the process, we have also developed tools that have helped firms to implement the rules effectively and consistently.

The ISDA Standard Initial Margin Model means that rather than developing their own IM calculation methodology, firms can use an industry standard model that has been developed and refined over time. Given the challenges associated with IM documentation, we also encourage firms to consider using ISDA Create, which allows them to negotiate and execute documents online, drastically reducing time, resources and risk.

Phase six will certainly be a challenge, but as long as market participants prepare well in advance and take advantage of the resources and mutualized solutions that are available, I am confident we will successfully complete the implementation of these important regulations next year.

Our agenda today includes sessions on both reporting and margin, and I’m looking forward to hearing the perspective of our speakers on these important topics.

Thank you.