ISDA Annual General Meeting
April 18, 2024
Chairman's Remarks
Eric Litvack, ISDA Chairman

Ohayō gozaimasu.

Koko Tōkyō ni kuru koto ga dekite kōeidesu. Go raijō itadaki makotoni arigatōgozaimasu.

I hope I managed to express how pleased I am to be here in Tokyo with you all.

As well as being a stunningly beautiful country, Japan takes its own important place in the history of derivatives markets, which makes it an ideal location for this year's Annual General Meeting (AGM).

Last year in Chicago, I talked about the role the Chicago exchanges played in the development of a modern derivatives market, with the Chicago Board of Trade introducing the first standardized futures contracts in 1865.

An equally important development occurred in Japan more than 130 years earlier with the emergence of rice futures trading, which led to one of the earliest commodities futures trading bourses – the Dojima Rice Exchange – in 1730.

It's another reminder that derivatives have been with us for a very long time, used in various forms throughout history because they are a fundamental tool for managing risk and facilitating the development of commerce. By enabling people to alleviate uncertainty, transfer risk and enhance profitability, these instruments serve an important economic and social need and contribute to growth and prosperity.

That's as true now as it was in 18th century Japan. Just as the Dojima Rice Exchange enabled growers and merchants to lock in the cost of future rice sales and purchases, derivatives are used today by companies around the world for similar reasons – to manage interest rate, foreign exchange (FX), credit and equity price risk; to manage the price risk of their agricultural crops and produce; to manage the cost of their energy consumption or production; to bring certainty and stability to production, commerce and investment throughout the value chain.

Of course, derivatives markets have not remained static in the 294 years since the formation of the Dojima Rice Exchange. While the concept and basic techniques of risk management are more or less unchanged, the markets, instruments and underlying legal and regulatory systems are much more sophisticated – and they are constantly evolving.

Let me give you an example. This is my 10th year as ISDA chairman, and since it's unlikely that I will have the honor of addressing you as chairman 10 years from now, it's a good opportunity to take stock of the progress we've made together. My first AGM as ISDA chair was in Montreal in 2015. I can see some faces in the room today who were present then and will remember that we discussed ISDA's work to broaden access to derivatives clearing and prepare for the multi-year challenge of non-cleared derivatives margin requirements.

Fast forward to today, and those issues have been effectively navigated. Notably, development of the ISDA Standard Initial Margin Model meant there was a common methodology that everyone could use to calculate initial margin, enabling the successful rollout of margin requirements by reducing the potential for disputes.

Thanks to industry initiatives like this, the market has evolved; we've moved on.

Today, we're focused on very different issues to those we debated in 2015. Geopolitical risk is now a major consideration following the invasion of Ukraine and instability in the Middle East. The impact of generative artificial intelligence on financial services is also in the spotlight – something many would have associated more with the pages of science fiction back in 2015. In the words of the Steve Miller Band, time keeps on slippin' into the future…and it puts an onus on all of us to find the solutions.

At ISDA, we're focused on a raft of new initiatives, from the digitization of derivatives markets to establishing legal standards for trading in voluntary carbon credits and other environmental, social and governance-related products – issues that were barely on the horizon in 2015.

Along with these new initiatives, there's also been a continued evolution of some long-standing areas of focus for ISDA, like regulatory reporting and capital. I'd like to touch on both of those issues this morning.

First, reporting. Reporting requirements introduced in the aftermath of the 2008 financial crisis have vastly increased the amount of data available, but regulatory reporting has become the problem child of post-crisis reform. As each jurisdiction developed its own set of rules, it created a complex 3-D puzzle of overlapping and divergent requirements, leading to inconsistencies in what was reported and the format in which it was submitted.

To their credit, regulators recognized the problem and agreed a globally harmonized set of data standards, which they are now in the process of incorporating into their respective rules, starting with the US Commodity Futures Trading Commission, and followed by the Japanese Financial Services Agency earlier this month.

This is a big step forward, but it doesn't fully eliminate the potential for discrepancies, partly because some variation continues to exist, but also because each firm needs to individually interpret what the rules require. Those interpretations can differ, leading to continued errors and inconsistencies in what is reported. This undermines the quality of the data collected by supervisors – and is a source of excess cost and risk for reporting entities.

A compelling solution is for the industry to agree a single, golden source interpretation of the rules that everyone can use – which is something ISDA has been doing. And we've taken it a step further with our Digital Regulatory Reporting (DRR) initiative by converting that industry-agreed interpretation into code using the Common Domain Model, which firms can then use as the basis of their implementation.

Just think about that. Rather than devoting resources and costs to interpreting and implementing each set of rules, and then doing it all over again if the rules change in future, firms can instead use a code that is tested and validated by industry participants. This allows resources to be redeployed to other projects and reduces the potential for regulatory penalties due to misreported data.

Now, there is some initial heavy lifting to get started, as with any IT project, but we think the cost and efficiency benefits more than make this worthwhile. If you haven't already, I would urge you to visit the ISDA stand in the exhibitor area to find out more. If there's one thing I'd like you to take away on this issue, it's a fear of missing out.

The big problem with reporting was a lack of consistency, but, in some respects, this is understandable. There was no single blueprint from which regulators were working, other than high-level direction by the Group-of-20 to require the reporting of all derivatives trades.

The same cannot be said of the capital rules. These standards are set by the Basel Committee on Banking Supervision and represent the views of 45 central banks and supervisors from 28 different jurisdictions. You'd therefore expect the rules to be consistent when implemented at the local level.

Unfortunately, that's proving not to be the case. We now have a good idea of how each of the major jurisdictions plans to implement the standards, and there are some stark differences on several levels.

Timing is one. Although the Basel Committee had anticipated a globally aligned implementation, individual jurisdictions have set their own timelines. For example, certain Japanese banks had to adhere from last month, EU banks are currently due to start from January next year, and US prudential regulators have proposed to implement their rules from mid-2025 – timing the UK has now also adopted.

However, we think the mid-2025 deadline for the US may be unrealistic due to the large number of comments that need to be reviewed and the need for revisions. In our own response to US agencies, we recommended the rules should become effective no earlier than 18 months from the publication of the final rule to ensure banks have sufficient time to implement the requirements.

Having a staggered, uncoordinated rollout is far from ideal and would result in unnecessary complexity for internationally active banks. This complexity also indirectly impacts the investors that provide the banks' capital, as well as the end users that consume their services. We therefore urge regulators to coordinate on timing to minimize the prospect of banks having to comply with different rule sets at different times.

Aside from timing, the various legislative proposals diverge in their approaches. For example, US prudential regulators have opted to replace the advanced approaches with a new expanded risk-based approach – a methodology that no longer provides banks with the option to use internal models for credit risk, counterparty credit risk and the default risk charge.

This deviates from the Basel Committee and the approach taken by many other jurisdictions, which have retained this option for sophisticated banks. US agencies have also deviated from EU and UK regulators in how they've applied certain elements of the securities financing transactions and credit valuation adjustment (CVA) frameworks.

As we've done in other jurisdictions, ISDA conducted analysis to determine the impact of the US proposals, with input from eight US global systemically important banks. According to that analysis, market risk capital requirements would increase by between 73% and 101%, depending on the extent to which banks use internal models.

Now, we know banks worldwide are planning to shrink their use of internal models because of the complexity of the trading book requirements. That means the impact will likely be closer to the upper bound of 101%. In the US and around the world, that remarkable increase in required capital will be a challenge for the cost and availability of market risk services provided by banks. Back to the Steve Miller Band – this will indeed be a revolution.

As with all the proposals, our approach has been the same: to advocate for consistent, risk-sensitive and appropriate capital rules. As a result, we've proposed a number of calibration changes to US prudential regulators that we think better reflect the actual levels of risk.

Why does this matter? Because fragmentation and disproportionate increases in capital could force banks to retreat from certain trading and intermediary businesses, creating capacity constraints and raising financing and hedging costs for end users.

As our **latest whiteboard animation** explains, companies rely on derivatives when raising financing in capital markets to hedge their risks, which contributes to competitive, vibrant economies.

Given the important role that derivatives play in helping companies to raise financing and manage risk, and the part that banks play in enabling firms to access these instruments, we should strive to ensure the capital rules appropriately reflect levels of risk and, to the extent possible, are consistent across borders.

Here, we think the Basel Committee has a continued role to play. In several instances, divergences have emerged because of miscalibrations at the Basel level, prompting individual regulators to apply their own fixes.

For example, we think the Basel Committee's inclusion of client clearing transactions in the CVA capital charge is unnecessary and would result in inappropriately high capital requirements for clearing businesses – an activity that policymakers have encouraged since the financial crisis. EU and UK regulators appear to agree, as they've opted not to include this requirement in their rules.

Likewise, implementation of the standardized approach for counterparty credit risk requirements has diverged internationally as different jurisdictions have sought ways to alleviate excessively burdensome standards.

Now, there will always be some instances of divergence, as regulators will inevitably adapt certain requirements to suit the individual characteristics of their domestic markets. But if those deviations are rife, it suggests there's something wrong with the standard itself.

We think the Basel Committee has a responsibility to relook at this. It's not good enough to agree a particular standard, see it deployed differently by different regulators and then simply shrug your shoulders.

These deviations have an impact. If each jurisdiction takes its own path, it creates challenges for globally active firms to manage risk consistently and efficiently. It also makes it much more difficult for banks to service their international clients, reducing competition and choice.

We would urge the Basel Committee to look closely at why these deviations have occurred and how individual jurisdictions have responded and then revisit the standards. We need a baseline set of requirements that work across the world and enable efficient risk transfer.

In the meantime, ISDA will work with regulators to highlight the worst excesses in the various national rules to achieve a framework that is risk appropriate and as globally consistent as possible. That will allow banks to continue providing the essential financing and risk management services that support economic growth.

I started my remarks by talking about the changes that have occurred in derivatives markets, even in the 10 years since I have been ISDA chairman. This extends to ISDA as well. Our organization has transformed in line with the market, covering the issues our 1,000-plus member firms care about and developing solutions like the DRR and many others I haven't had time to talk about today, which are designed to help firms in every corner of the market increase efficiencies and reduce costs.

This change is also reflected in the composition of the ISDA board, which is more diverse than ever before, mirroring the market we serve. As well as increasing the number of buy-side and infrastructure board members, I'm very proud that the proportion of women on the board has increased from 11% 10 years ago to 38% today.

I'd like to take this opportunity to thank my board colleagues for their hard work and unstinting commitment. I'd also like to thank all of our members, particularly the 12,000 of you who regularly participate in the working groups and contribute your time and expertise. Finally, I'd like to thank the ISDA staff who do such a great job of corralling the diverse views and arriving at a consensus position in order to achieve the best outcomes for the industry as a whole.

Of course, as we've seen, 10 years is just a drop in the ocean when put in context of the rich history of the derivatives markets. Next year, we'll experience another part of that story as we'll be heading to Amsterdam, birthplace of tulip futures in the 17th century. I very much hope to see all of you there.

Thank you. Arigatōgozaimasu.