ISDA Derivatives Trading Forum Tokyo
September 29, 2023

Introduction
Scott O'Malia, CEO, ISDA

Good morning and welcome to the Derivatives Trading Forum. Thanks for being with us today, and thank you to all our speakers and exhibitors.

This is the fourth in a series of events that have taken place in Sydney, New York and Hong Kong, with another to come in London in November. It's a valuable opportunity to meet with market participants and policymakers in these four centers to consider both local and global market issues.

There's certainly no shortage of topics to discuss. It's now three months since the last five US dollar LIBOR settings were retired on June 30, but the benchmark reform process is not yet over. Here in Japan, market participants have been considering the future of euroyen TIBOR, and a decision to cease publication could be taken by the end of March. If so, market participants will need to consider how to safely transition to alternative rates.

At the same time, banks are preparing to implement the final parts of the Basel III framework, including revised capital requirements for market risk and credit valuation adjustment. We now have clarity on the expected approach of key jurisdictions around the world, including Japan. Important questions have been raised about the overall capital impact of the rules, the degree of consistency between jurisdictions and the risk sensitivity of the standards.

In these remarks, I'll briefly outline ISDA's efforts to support a safe and efficient benchmark transition. I'll also touch on the recent Basel III developments and some of the divergences that have emerged. I'll then turn to another area where ISDA is helping to bring greater efficiency to derivatives markets – by developing a suite of mutualized digital solutions.

Benchmarks

I'll start with benchmarks.

The transition from LIBOR was arguably the biggest structural change in the history of financial markets. With hundreds of trillions of dollars of contracts linked to LIBOR, many people believed it simply couldn't be done.

The fact it was achieved on schedule and with very little market disruption is thanks to unprecedented cooperation and coordination between the public and private sectors over a period of seven years. Through a combination of industry efforts, legislative solutions and public sector initiatives, we have successfully consigned LIBOR to the history books.

ISDA's role in this effort began in 2016, when we were tasked by the Financial Stability Board to take the lead in improving the contractual robustness of derivatives referencing LIBOR and other key interbank offered rates (IBORs).

In response, we developed standard fallbacks that ensure certain IBOR contracts that have ceased to exist or (in the case of LIBOR) become non-representative automatically switch to an adjusted version of the relevant risk-free rate. We incorporated these fallbacks into ISDA's standard definitions and developed the ISDA 2020 IBOR Fallbacks Protocol. With more than 16,200 adherents across 92 countries, the protocol played a critical role in the smooth transition from LIBOR.

But the work doesn't stop there. In the coming years, we could see the retirement of several other IBORs, which will require the same disciplined approach that proved effective for LIBOR. In Japan, for example, JBA TIBOR Administration launched a consultation in August on whether to stop publishing euroyen TIBOR and, if so, over what time frame. That consultation will close tomorrow, and the results are expected to be published by March 31 next year.

If it's decided to cease publication of euroyen TIBOR, the experience of LIBOR shows how a benchmark can be retired safely and effectively. It's important to note that the ISDA fallbacks already cover euroyen TIBOR, providing a ready-made safety net for those firms that have adhered to the protocol.

We'll watch the results of the euroyen TIBOR consultation carefully and will work with the industry and policymakers to provide the necessary resources to support any transition.

Capital

I'll now say a few words on capital.

On July 27, US prudential regulators published their long-awaited notice of proposed rulemaking to implement the final parts of the Basel III framework. That means we now know how all the main jurisdictions intend to approach these important standards.

In Japan, the rules are expected to take effect for some banks as early as March 2024. UK and EU proposals are currently due to be implemented from the start of 2025, while US regulators have proposed to begin implementation from July 1, 2025. A staggered rollout could create distortions and complexities for internationally active banks, as they would have to comply with different rule sets at different times.

Legislative proposals have also diverged in other ways, with some jurisdictions adopting a more conservative approach in certain key areas. ISDA strongly believes capital rules should be risk sensitive and appropriate. Disproportionate increases in capital could force banks to curtail certain trading and intermediary businesses, creating capacity constraints and raising financing and hedging costs for end users.

We hope there will be an opportunity for the Basel Committee to revisit this rulebook and determine whether certain targeted adjustments may be warranted to ensure a risk-appropriate, globally consistent framework and avoid fragmentation in financial markets.

Digitization

I'll now turn to ISDA's efforts to drive efficiencies and cost savings in derivatives markets through our digitization initiatives.

Financial markets have relied increasingly heavily on technology in recent years, but when it comes to the nuts and bolts of how this market works, we persist in making it more complex than it needs to be. In an age of smart phones, smart TVs and even smart fridges, we continue to use paper documents, manual processes and non-standard practices when managing and processing derivatives trades.

ISDA has been working to address this by developing industry solutions designed to bring greater efficiency, standardization and automation to derivatives markets. We're now taking this effort to the next level by bringing all our digital solutions and team members who handle digital transformation under a single umbrella – a change designed to not only align our solutions, but to encourage innovation and ensure we're prioritizing the issues the industry wants solved.

Our reason for doing this is simple: there are certain processes that we think benefit from having automated, standardized industry solutions, eliminating needless inconsistencies, errors and risks.

For market participants, it's far cheaper and more efficient to use a mutualized solution for those tasks where there's no competitive advantage from going it alone. This is what drove the development of our first industry solution – the ISDA Standard Initial Margin Model. Given counterparties must ultimately agree on the margin amounts that need to be exchanged, there was simply no benefit for each firm to spend time and money building its own unique model.

Since then, we've developed other mutualized platforms and services that digitize critical processes in the derivatives market. From ISDA Create, which enables the online negotiation and execution of flagship derivatives documents, to the Perun quantitative analysis platform that underpins our capital benchmarking initiative, ISDA's digital solutions have been developed in close collaboration with our membership to reduce risk and create efficiencies.

We also developed the Common Domain Model (CDM), a free-to-use data standard for financial products, trades and lifecycle events, which has been effectively deployed in the derivatives market to digitize regulatory reporting and key collateral management processes.

For regulatory reporting, the first phase of our digital initiative was launched last year, ahead of reporting rule changes introduced by the US Commodity Futures Trading Commission on December 5, 2022. By using the CDM to transform a mutualized interpretation of the requirements agreed by an ISDA working group into machine-executable code that anyone can use, firms can avoid the need to dedicate time and resources to interpreting the rules themselves. This creates significant efficiencies and cost savings while delivering more accurate and consistent data to regulators.

We're now planning to extend our digital regulatory reporting initiative to cover rule amendments in Europe and Asia-Pacific, beginning in April 2024 with the EU and Japan.

A key part of our effort has been to digitize our legal documentation. ISDA's MyLibrary platform now hosts around 90 derivatives documents in digital form, meaning firms can quickly pinpoint crucial contractual terms rather than trawling through hundreds of pages of legal documents.

New documents are being added to MyLibrary all the time, and we're now exploring the use of artificial intelligence to make that process quicker.

Having developed these services and solutions, we're aligning them under a single digital transformation team. This new dedicated group will focus on identifying key industry needs across our full suite of platforms to ensure we're prioritizing our efforts where they are most needed in a consistent and coherent way.

I'd like to briefly highlight two new developments, which have come as a result of industry feedback. First, I'm delighted to say that ISDA Create is now available through S&P Global Market Intelligence's Counterparty Manager service.

Counterparty Manager includes ISDA Amend, an online tool that enables users to make changes to their ISDA documents and exchange information to comply with regulations. By linking Counterparty Manager with ISDA Create, users will be able to access a complete digital record of all relationship and contractual data entered on either platform.

Having all of this data available in one place, at the click of a few buttons, will save firms huge amounts of time and effort, avoiding the need to scan through multiple systems to locate critical information they need about their trading relationships.

We're really excited about this initiative, as it brings us one step closer to having a single golden source for all contractual information.

The other new initiative will be a key focus for our new integrated digital transformation team over the coming year – the development of an industry notices hub.

As it stands, the ISDA Master Agreement prescribes certain methods for delivering critical notices to counterparties using the company address listed in the agreement. But problems can occur if the company has moved and the ISDA Master Agreement hasn't been updated with the new details.

Issues related to the delivery and receipt of notices were particularly acute during the pandemic, when offices were subject to lockdown requirements. This created challenges for firms when delivering notices, and made it difficult for their counterparties to know they had received them.

An industry notices hub would act as a central platform for firms to load notices, with automatic alerts sent to the receiving entity. Designated people at each firm would be able to access the hub from anywhere in the world, regardless of the situation at its physical location.

This idea is still in the early stages, and there are some legal and technological issues that need to be considered. But the concept has received strong initial support from our members and indications of interest from some resolution authorities.

We’ll keep you updated as this important initiative develops, but please let us know if you want more details or would like to be involved in the working group.

We know there’s a strong appetite for efficiency and cost reduction across the industry. We want to maximize the potential to achieve that by making the most of what we already offer – by advancing and innovating existing solutions – and identifying new areas where digital solutions can create efficiencies. Of course, those efficiencies will increase as more and more firms implement the same mutualized solutions, so a key focus for us will be on raising awareness and encouraging adoption.

These three prongs – align, advance and adopt – will be at the center of our digitization initiatives, led by our new digital transformation team. We believe this will contribute to a more standardized, automated and efficient derivatives market.

Thank you.