ISDA held its Annual General Meeting in Madrid on May 10-12, with a major focus on the development of crypto and sustainable finance, as well as LIBOR transition, digitisation and capital regulations.

ISDA Focuses on Crypto Standards

Derivatives linked to crypto assets are growing fast, and ISDA is working to develop contractual standards that will bring order and efficiency to this fast-evolving market, according to Scott O’Malia, ISDA’s chief executive.

In his opening remarks on the first day of the ISDA Annual General Meeting (AGM) on May 11, O’Malia said distributed ledger technology has the potential to reshape both retail and wholesale financial services. With rising demand from institutional investors and a rapidly growing derivatives market, ISDA is focusing on developing contractual standards that reflect the unique aspects of this asset class.

“Just as the ISDA Master Agreement brought order to the chaos of the nascent derivatives market 35 years ago, we believe standards will bring the same clarity and consistency to over-the-counter (OTC) crypto derivatives. We are moving fast towards a contractual framework to include cash-settled forwards and options referencing Bitcoin and Ether, which we want to launch later this year,” he said.

ISDA last year established a Digital Assets Legal Group, which includes a number of ISDA members active in crypto, including B2C2, Coinbase, FalconX and FTX. ISDA subsequently published a paper that explores distinctive events in the digital assets space that would need to be addressed in any contractual standards for OTC derivatives. These include forks, where a blockchain is upgraded or modified, which can change the nature of the blockchain or lead to the creation of two distinct crypto assets, as well as airdrops, which involve the unilateral issuance of a new digital asset to the holders of an associated digital asset.

“Just like any other asset class, crypto derivatives require precise and consistent terms and standards that reflect their unique features,” said O’Malia. “By combining the knowledge of our crypto members with the standards that have been developed for traditional finance, we will be successful in drafting robust and consistent definitions.”

Also speaking on day one of the AGM, FTX founder and chief executive Sam Bankman-Fried agreed the development of standard definitions and templates would bring greater efficiency and uniformity to the market.

“When you start looking at things like corporate actions or the equivalent of corporate actions in crypto land, which, in this case, would mean things like token splits, each venue handles it differently and sometimes they don’t really define clearly ahead of time how they are going to handle it. You’re left basically guessing at how you think that’s going to work and hoping you got it roughly right – it’s a pretty big mess. And that’s not going to make it easy for institutions to get involved in this space,” he said.

The need for contractual standards was also raised by speakers on a crypto panel on May 12. As well as bringing greater efficiency and consistency, having specific ISDA documentation for crypto derivatives would increase comfort levels for institutional investors looking to get exposure to this asset class, said Nicola White, president of B2C2 USA, a cryptocurrency liquidity provider.

“Right now, about 60% of our clients are coming from the traditional finance space. They are looking to get into the space primarily through derivatives as their first foray – they’re not necessarily ready for exposure to the blockchain. They want to get into something they’re comfortable with, they’re used to and their systems support. On top of that, ISDA [documentation] is something they are very familiar with – it’s efficient and they understand everything that’s in there. I think adapting the ISDA [documentation] for crypto-specific things like forks and airdrops becomes very important,” she said.

“Just like any other asset class, crypto derivatives require precise and consistent terms and standards that reflect their unique features”

Scott O’Malia, ISDA
Collective Action and Integrity Critical to Green Transition

Reducing carbon dioxide emissions to net zero by 2050 will require collective action across the financial sector to ensure rapid progress is made without enabling greenwashing, according to market participants and regulators who spoke during ISDA’s Annual General Meeting (AGM) in Madrid.

Speaking in an interview with ISDA chief group executive Scott O’Malley, Standard Chartered group chief executive Bill Winters said that while every entity in the world must play its part to reduce emissions, additional market mechanisms will be needed to prevent excess warming. A voluntary carbon market with high-quality standards and governance will be critical, said Winters, who chaired the Taskforce on Scaling Voluntary Carbon Markets (TSVCM).

“Markets can be instrumental in solving this problem and getting money from the pockets of people who are looking to do the right thing into the pockets of people who can actually get that thing done. The TSVCM was the first pass at getting a high-quality and well-governed process in place, so we can have confidence the money put into the purchase of offsets is actually having the desired effect on the aggregate level of emissions,” said Winters.

The need to maintain integrity in the rapidly growing environmental, social and governance (ESG) space was a recurrent theme at the AGM, as speakers agreed on the importance of tackling greenwashing. In a keynote address, Martin Moloney, secretary general of the International Organization of Securities Commissions (IOSCO), described greenwashing as one of the biggest challenges in the transition to net zero.

“I know greenwashing is not always intentional – it’s not always driven by a desire or an intent to deceive people – but that only gives you so much consolation, because the fact is that greenwashing is very widespread at this point in time. At IOSCO, we worry about the reputation of financial markets, about the commitment of society to facilitate and allow financial markets to do what they do, and anything that, on a global level, undermines that reputation is a risk from our point of view,” said Moloney.

Speaking during a panel discussion at the start of the AGM, Sacha Sadan, director of ESG at the UK Financial Conduct Authority (FCA), also highlighted the need to improve trust in the sector. “There is a lot of greenwashing out there, let’s be honest, and one of the things we need to do is to get the trust back, because people will end up losing trust quite quickly,” he said.

But Belinda Ellington, managing director and general counsel, global commodities, ESG for global markets at Citigroup, argued that greenwashing is not as widespread as some fear and financial institutions are creating liquidity in voluntary and compliance carbon markets that will be critical to the success of the green transition.

“I think the definition of greenwashing doesn’t exist at the minute and it’s important to understand that organisations need to transition to net zero and to a sustainable economy, and that process of transitioning is sometimes tarred with the greenwashing brush,” said Ellington.

Panellists agreed on the need to turn commitments into actions and ensure tangible progress is made. In response to an audience poll asking where organisations are on the path to net zero, 43% said they are either getting organised or still at the starting gate. Only 45% felt they are running with the pack.

Sudan, who recently joined the FCA from Legal and General Investment Management, said the regulator is not interested in whether a financial institution has made a commitment to net zero, but is more focused on what steps it is taking. “It’s a path to net zero – we never thought we’d get there in one go and I’m not saying we’re even on the track at the moment, but what matters is what you’re doing,” he told delegates.

“Markets can be instrumental in solving this problem and getting money from the pockets of people who are looking to do the right thing into the pockets of people who can actually get that thing done”

Bill Winters, Standard Chartered

For Standard Chartered, the decision to embed sustainability at the heart of its strategic agenda was driven by the realisation that the bank’s customers will bear a disproportionate share of the downside if progress is not made, according to Winters. Nineteen of the cities in which the bank operates would be underwater in a two-degree-Celsius scenario, while almost half the population it serves would live half the year in unbearable temperatures, he said.

Developing robust and consistent standards to support the development of carbon markets and sustainability-linked derivatives (SLDs) will be a very positive step forward in the green transition, Winters added.

“In the context of sustainability, you can do some really good things in a highly customised way, but you won’t make a really big impact either on your P&L or on society. You have to get some transparent standards. If we can get a consistent set of standards and as much fungibility as possible between voluntary and compliance markets, then we can start to introduce a carbon price into SLDs, with an opportunity to really scale that market,” said Winters.
In brief

Capital for Crypto Won’t be Diluted, Says Basel Committee Chair

The Basel Committee on Banking Supervision will maintain a simple and cautious approach to the capitalisation of crypto assets and market participants should not expect it to water down its proposed approach in response to stakeholder feedback, the committee’s chairman has warned.

“The design and calibration of prudential regulation should reflect our level of knowledge when it comes to new asset classes, including the lack of historical data and our ability to measure and mitigate risks. In this regard, diluting bank capital requirements because of a fear that crypto-asset activities will migrate outside the regulated banking system is not a convincing argument,” said Pablo Hernández de Cos, Basel Committee chair and governor of Banco de España.

Speaking at ISDA’s Annual General Meeting (AGM) in Madrid on May 12, Hernández de Cos acknowledged the extraordinary growth of crypto assets and said that while banks’ direct exposures are currently relatively limited, this could change very quickly and pose risks to individual banks and overall financial stability.

“Banks’ direct and indirect exposures to crypto-asset markets can in principle arise through a wide range of channels. Indeed, the committee has identified no fewer than 20 potential such channels for banks, including in their capacity as lenders, issuers, providers of custody services or as market makers. This calls for a forward-looking approach to regulation and supervision to ensure that we continue to meet our mandate today and in the future as technology and market developments continue to evolve,” said Hernández de Cos.

The Basel Committee published a proposed prudential framework for crypto exposures in June 2021, dividing the market into two groups. Group-one assets are those such as stablecoins and tokenised assets that meet certain classification conditions and can be capitalised under the existing Basel framework with some modifications. Group-two assets are those such as Bitcoin that do not meet the classification conditions and would be subject to a conservative risk weight of 1,250%.

In his opening remarks at the AGM on May 11, ISDA chief executive Scott O’Malia reiterated concerns raised in response to the Basel Committee consultation last year that a very conservative capital treatment of crypto assets would make it difficult for banks to participate in this market in a meaningful way.

“The proposed 1,250% risk weight for certain crypto assets is designed to ensure banks hold capital at least equal in value to their exposures. We think this is excessive. Capital standards that more appropriately reflect the risk of crypto assets would enable banks to respond to client demand – in turn, broadening market participation and liquidity,” said O’Malia.

But Hernández de Cos suggested that if crypto-asset activity exists outside the regulated banking system, then the appropriate response would be to bring these areas within the relevant regulatory perimeter. The Basel Committee plans to issue a further consultation paper in the coming months, but Hernández de Cos indicated the guiding principles had not changed. In maintaining simplicity and caution, the Basel Committee should avoid the “illusory quest for ‘perfect’ risk sensitivity”, he said.

Hernández de Cos also stressed the importance of complete implementation of the remaining parts of the Basel III reforms, in the collective interest of banks and regulators. The Basel Committee will evaluate the impact of all its reforms after they are implemented, but the time for negotiation and lobbying is now over, he said.

“Implementing all aspects of the Basel III framework in a full, timely and consistent manner is an imperative for our member jurisdictions. Events over the past two years, including the pandemic and the Ukraine conflict, have once again highlighted the importance of having a prudent and robust regulatory framework in place,” said Hernández de Cos.

He highlighted several shortcomings in relation to banks’ trading books that needed to be addressed, including the boundary between the banking book and the trading book, internal models that lacked robustness and could not account for the magnitude of extreme financial shocks, and the lack of an appropriate standardised approach to serve as a credible fallback to internal models.

“A fundamentally redesigned standardised approach will bring greater risk sensitivity and serve as the basis for calculating market risk requirements for the output floor. This, in turn, will help ensure that banks’ modelled capital requirements do not fall below a certain level. It will also facilitate the comparability of banks’ market risk profiles within and across jurisdictions,” said Hernández de Cos.

The European Commission began the process of transposing the final parts of Basel III when it published legislative proposals in October 2021. Other jurisdictions are expected to issue their own proposals in the coming months.
Regulators Eye Crypto Market

Regulators are planning to up their oversight of crypto markets, amid concerns the rapid growth of the sector poses potential financial stability risks, as well as investor protection and market manipulation issues.

Speaking at the ISDA Annual General Meeting (AGM) on May 12, Martin Moloney, secretary general of the International Organization of Securities Commissions (IOSCO), warned about the hype associated with crypto, and said it was time for regulators to enter a new phase of engagement with crypto firms.

"What I would say to those who advocate 'leave us alone, don't let regulation come anywhere near us, we are the innovative wild west, we are going to do really new things and would you guys just keep away from us' — well, I think for those of you who have seen your westerns, it's kind of time for a sheriff to come to town," said Moloney.

The crypto sector should be prepared to meet the same standards that exist for traditional finance, he added — but that doesn't mean firms need to apply those standards in exactly the same way. "I think this is where the industry can continue to legitimately challenge regulators and say 'why are you making us do it the same way if we can find a safe way to do it that is new or different that meets your standards, meets your goals'. And I would say that's a great argument for the industry to make to regulators, a much better argument than 'leave us alone, we are the pirates of freedom'."

Speaking a day earlier, Klaas Knot, chair of the Financial Stability Board (FSB) and president of De Nederlandsche Bank, said the FSB is also looking closely at this space given increasing interconnections between the traditionally regulated financial sector and crypto, challenges with consumer and investor protection and concerns about money laundering, cyber crime and ransomware.

"The bottom line of our assessment is that crypto-asset markets are fast evolving and could soon represent a threat to global financial stability. The rapid evolution and international nature of these markets also raise the potential for regulatory gaps, fragmentation or arbitrage. For these reasons, policy work on crypto assets is a priority for the FSB," said Knot.

While noting that important parts of the crypto ecosystem currently operate outside the regulatory perimeter, Knot added that digital asset markets are not operating in a completely lawless environment — and a key step for regulators will be determining how far existing standards address the risks posed by the sector and whether any gaps exist.

Addressing delegates on May 11, Gary Gensler, chair of the US Securities and Exchange Commission (SEC), argued that a large portion of crypto spot and derivatives trades in the US qualify as securities or security-based swaps and therefore must meet existing US securities regulations.

"Make no mistake: if a swap is based upon a crypto asset that is a security, then that is a security-based swap. Thus, our rules apply to them. Any offer or sale to retail participants must be registered under the Securities Act of 1933 and effected on a national securities exchange," he said.

"While short term, it's been a huge focus area for us and taken a ton of our time and attention, not to mention probably $1 billion-$2 billion, it has put us in a position to be able to operate legally in a licensed manner in most of the world and be able to interface with institutions that are going to require exchanges that are living in the light of day. So I'm optimistic that, long term, it's going to be an advantage and it's going to set us up for success, although it's certainly the case that it has slowed us down a bit in the short term," said Bankman-Fried.

Other crypto firms said they were also working within the existing regulatory framework. Speaking on a crypto panel on May 12, Nicola White, president of B2C2 USA, a cryptocurrency liquidity provider, said the company is regulated across multiple jurisdictions and is looking to become a swap dealer under US rules. However, she called for greater clarity on the regulatory framework for crypto — a point echoed by James Stickland, chief executive at Elwood Technologies, a crypto trading platform.

"I think everyone wants transparency, especially on an institutional level. It's far more helpful to understand what we can't do versus what we might be able to do," he said.

"I think for those of you who have seen your westerns, it's kind of time for a sheriff to come to town"

Martin Moloney, IOSCO
Collaboration Helped LIBOR Transition, Says CFTC’s Behnam

Behnam gave an update on key topics on the CFTC’s agenda, including LIBOR, implementation of initial margin (IM) requirements, data reporting, climate risk and digital assets, committing to transparency in the agency’s standards and processes. The CFTC is seeking to be both resilient and responsible as it considers upcoming challenges, he said.

“As our present and future challenges require us to assess risks borne from newer and more novel sources, our ability to adapt swiftly from theory to practice will be tested over and over again. Our challenge will be doing so in a manner that minimises market disruption, maximises the risk-mitigating opportunities within our interconnected markets, and ensures a level of fairness that cannot be undermined by regulatory arbitrage,” said Behnam.

With less than four months to go until the phase-six implementation date for IM requirements for non-cleared derivatives, Behnam stressed there will be no further relief and in-scope entities will be expected to meet the September 1 deadline.

“Preparation for compliance with the regulatory IM requirements is complex and resource intensive, involving the bilateral negotiation of new documentation, the establishment of custodial accounts and operational preparations for the exchange of IM and collateral management. ISDA has diligently worked with the industry to assist and support firms with preparation and compliance ahead of the fast-approaching deadline,” said Behnam.
In brief

ISDA Solutions Address Industry Challenges, Says Litvack

ISDA has continued to develop mutualised industry solutions to help market participants address a range of immediate and long-term challenges, ranging from LIBOR transition and Russian sanctions to regulatory reporting and implementation of Basel III standardised capital models, according to ISDA chairman Eric Litvack.

“As chairman of the ISDA board, I'm immensely proud of ISDA’s leadership on fallbacks, which went a long way to mitigating the potential systemic risk of the LIBOR transition. This is one example of how ISDA has been instrumental in tackling a difficult challenge, but there are many others. In some cases, ISDA has had to turn on a dime to respond to industry issues. In others, a longer-term approach has been taken to anticipate future needs and lead the market to solutions,” said Litvack during chairman remarks on the second day of ISDA’s Annual General Meeting.

Litvack heralded the 2021 ISDA Interest Rate Derivatives Definitions, implemented in October 2021, as an example of an industry solution that involved long-term vision and planning. As well as including modifications to reflect current market practices, conventions and regulatory requirements, the 2021 Definitions were the first to be published in purely digital form via the MyLibrary platform. This means a new consolidated version of the definitions can be republished digitally whenever an update is needed, without the need for supplements.

“The 2021 Definitions are an example of ISDA leading the industry and designing a solution fit for a changing market. Of course, change is never easy, but adoption is fast gathering pace. All cleared interest rate derivatives and about two thirds of electronically confirmed trades in the non-cleared market now reference the new definitions. It has essentially become the de facto standard for interest rate derivatives,” Litvack said.

Meanwhile, ISDA’s Standardized Approach (SA) Benchmarking initiative has enabled banks to implement the new, more complex standardised capital models under Basel III accurately and consistently. So far, 71 banks have participated in the initiative, while 16 supervisors have used the data to monitor implementation in their jurisdictions.

“As individual jurisdictions publish draft rules to implement the final Basel III measures and banks gear up to meet the requirements, ISDA’s focus will be on bringing as much efficiency as possible to the implementation process. ISDA SA Benchmarking will be a key part of that effort,” said Litvack.

Watch ISDA’s new animation video on the benefits of DRR: bit.ly/3wzR0XR

DRR Offers Upsides for Trade Reporting

The development of digital regulatory reporting (DRR) will bring improvements to the accuracy and transparency of derivatives trade reporting, significantly reducing the resource burden on market participants, according to speakers at ISDA’s Annual General Meeting (AGM).

“The concept of having that single repository that fundamentally can be modified as new rules come in, or changes or modifications to the rules happen, could really reduce the overall cost of change to the industry,” said Valentino Wotton, managing director, product development and strategy, repository and derivatives services at DTCC.

The DRR is a mutualised industry initiative that enables firms to interpret and implement regulatory reporting rules consistently using a common machine-readable code based on the Common Domain Model (CDM). More than 40 institutions, including buy- and sell-side firms, have contributed to ISDA’s DRR working groups, modelling regulatory reporting rules based on peer-reviewed interpretations of the requirements.

“Having a single accepted code for each rule set will avoid the need for firms to devote resources to interpreting the requirements and building their own reporting logic, enhancing efficiency and reducing costs. For their part, regulators will have full transparency into how the rules are being applied. Critically, they will also receive better quality data that is more accurate and consistent, helping them to monitor potential sources of risk,” said Eric Litvack, chairman of ISDA, in his remarks at the AGM on May 12.

The DRR is initially focused on the Commodity Futures Trading Commission’s revised swap data reporting rules, which are due to come into force in December 2022. Subsequent phases of the project will digitise the revised EU trade reporting requirements under the European Market Infrastructure Regulation, expected to come into force in 2024, as well as requirements set by regulators in Asia-Pacific.

“ISDA and the derivatives industry have long experience in developing standards, and both therefore see the benefits of standards, but also the pain when standards aren’t there. The difference today is the breadth with which we’re developing standards – historically, they were developed for operational purposes to allow information exchange to facilitate trading, but now we’re looking at a much broader set of standards,” said Angus Moir, head of data collection transformation at the Bank of England.

Watch ISDA’s new animation video on the benefits of DRR: bit.ly/3wzR0XR
The 2021 ISDA Interest Rate Derivatives Definitions have become the market standard for interest rate derivatives, and firms that continue to use the 2006 booklet are using definitions that are now stale, according to Katherine Tew Darras, ISDA’s general counsel.

“Additional versions of the 2021 Definitions have been published without corresponding amendments to the 2006s, so the 2006s are stale at this point and users should be aware of that. We will not be making future amendments to the 2006 Definitions, so if you are still using them, you may be negligent in doing so,” she said.

Speaking on a digital documentation panel at the ISDA Annual General Meeting on May 11, Tew Darras noted that adoption of the 2021 Definitions had increased significantly since their implementation in October 2021.

All major central counterparties incorporated the new definitions into their rule books in the last quarter of 2021, meaning all legacy and new cleared trades reference the 2021 Definitions. Data from OSTTRA’s MarkitWire platform in April showed that 68% of non-cleared interdealer and 65% of non-cleared client interest rate derivatives electronically confirmed on the platform also now reference the new definitions. That compares with around 15% in October 2021, after the definitions went live.

The 2021 Definitions are the first to be published in purely digital form via ISDA’s MyLibrary platform, creating significant efficiencies in how firms use and interact with the definitions. The new definitions consolidate the 91 supplements to the 2006 ISDA Definitions into a single electronic booklet, reducing complexity and the potential for error. Each time updates are required, a revised digital version of the 2021 Definitions is republished in full, eliminating the need for further supplements.

Speaking on the panel, Biswarup Chatterjee, ISDA board member and managing director, head of innovation, global markets, at Citigroup, said the publication of multiple supplements to the 2006 Definitions had made it challenging for practitioners to quickly work out the exact terms of each trade – a problem that would now not exist with the 2021 Definitions.

“To get to a situation where, in 2021, we’re starting to see digital versions of these definitions come in, I think from a risk management, risk aggregation and risk reporting perspective, not only is this a great move for the practitioners, I’m sure for even the regulators, for whom reporting is very important, this is really going to be a more efficient path forward,” he said.

On May 9, ISDA announced that its flagship 1998 FX and Currency Option Definitions and 15 other related documents have also been added to the ISDA MyLibrary platform. As well as the 2021 Definitions, MyLibrary includes the 2002 ISDA Master Agreement and the 2022 ISDA Securities Financing Transactions Definitions and SFT Schedule Provisions.

This is one element of a broader transition to digital documentation and processes, said ISDA’s chief executive Scott O’Malia, speaking during day two opening remarks on May 12.

“Since the 1980s, we have constantly evolved our organisation and our documentation to address changes in the derivatives market and maintain robust foundations. Now we are going further to reflect our fully digital strategy, while not compromising on those strong legal foundations and product standards for which our documentation is renowned,” he said.

During the AGM, ISDA announced that the ISDA Create online documentation negotiation platform would be available within S&P Global Market Intelligence’s Counterparty Manager service, giving firms the ability to easily access full details of their contractual relationships in digital form from a single location. The initiative means users of either platform will be able to view a complete digital record of all relationship and contractual data exchanged and/or created on either platform.

“This is a big deal – it brings us one step closer to having a single golden source for all contractual information. Users will now be able to easily access a complete digital record of their relationship data entered on either platform – everything from ISDA protocols and disclosure data on ISDA Amend to ISDA Create contract and negotiation information,” said O’Malia.

“Having all of this information available at the click of a few buttons will save firms huge amounts of time and effort, avoiding the need to scan through multiple systems – or, worse, rummage through reams of paper documents – to get critical information they need about their trading relationships,” he added.

More information on the 2021 ISDA Interest Rate Derivatives Definitions is available here: bit.ly/37UBVoO

More information on the link between ISDA Create and Counterparty Manager is available here: bit.ly/3MrDD2y
Thanks to Our Sponsors

EVENING EVENT SPONSOR

LCH
AN LSEG BUSINESS

PLATINUM SPONSORS

DTCC  FALCONX  JSTTRA  S&P Global
Market Intelligence

GOLD SPONSORS

BNY MELLON  Linklaters

SILVER SPONSORS

AXONI  VLIFFORD CHANCE  KINETIX  Morgan Stanley
MUREX  QUANTILE  TRADE HEADER  XVA Blockchain

EXHIBITORS

acadia  Adenza  aosphere  BLOOMBERG  droit  FACTOR

ACCOUNTING MEETING SPONSOR  WIFI SPONSOR

EY  DLT
The AGM in Pictures
The AGM in Pictures