ISDA® Safe, Efficient Markets

Chairman's Address
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Thank you, Connie, and good morning to all.

It's been some five months since I was elected to be the Chairman of the Board of ISDA.

And as you know, it's been a busy time for all of us in the financial markets.

We've been focused on matters such as:

- The Greek debt crisis
- The US debt ceiling impasse
- Fears of financial contagion and
- Continuing concerns about a double-dip recession.

Amidst all of the tumult, one positive note: OTC derivatives have not factored much into any of these problems.

Yes, there have been flurries of news stories here and there.

But not a lot, at least by the standards of the past few years.

I would like to think that this reflects in part the hard work of ISDA and market participants

Your work is recognized and appreciated.

We've increased transparency and reduced risk.

Our work has enabled policymakers and others to have a more accurate, in-depth view of exposures.

And I hope it's leading to a more informed debate on the derivatives markets.

And that's what I would like to speak to you about today…our work to build Safe, Efficient Markets.

Safe, Efficient Markets …and how we can drive further progress now and in the years ahead.

This progress depends in large part on two critical factors.

First, the continued commitment of market participants around the world.

And second, a … consistent ….global …. regulatory framework - and a framework focused on systemic risk reduction.

Let me address each of these points in more detail.

Consider this: Is there another market that has moved as swiftly and as broadly to address its challenges as the OTC derivatives markets?

Think of the financial crises of the past 100 years.

Think of the Great Depression. 1970's stagflation and the S&L scandal

Think also of the:

- Asian financial crisis
- Long-Term Capital Management
- the dot.com bubble
- the '87 crash and the Flash Crash

Now think of the solutions to these events.

Two stand out: Glass-Steagall and Sarbanes-Oxley.

Both were government mandates that attempted to impose corrective actions on perceived problems.

Where though, were the private sector solutions?

Think now about what the derivatives markets have achieved over the last few years….

A massive amount of work has been done by the industry:

- We're clearing over 50% of interest rate swaps.
- The vast majority of derivatives activity between market professionals is fully collateralized
- Trillions of dollars of transaction volume has been eliminated by trade compression. And
- Swap data repositories have been built to report transaction data to regulators

In short, we really are working to build Safe, Efficient Markets.

We are reducing the risks of interconnectivity and increasing the transparency of those risks to global regulators.

This is right out of the G20 playbook. And there's much more progress to come.

Much of this potential lies in our ability to involve more types of market participants in our activities. So, when I referred earlier to continued commitment of market participants I meant all types of participants.

This is important.

It's my view, and it's ISDA's view, that our efforts in

- Clearing
- Collateral
- Trading infrastructure
- Documentation, and
- Risk management

…………are much stronger if we have <u>all types of market participants at the table</u> when we develop strategy and execute on that strategy.

On a personal note, this is a very important initiative for me.

It's the approach we took when I chaired the IIGC, the ISDA Industry Governance Committee, and also the approach of the Product Steering Committees, where buy-side participation has been essential to much of the progress made

Today, in fact, the IIGC has co-chairs. One person from the sell-side and one from the buy-side.

This cross-market approach been extremely successful in achieving our goals to reduce risk in the financial system

For example, it's the approach we took when we developed the Big Bang and Small Bang Protocols – which have had an enormously positive effect on CDS market liquidity and transparency

Broader, cross-market participation has also been a goal of the ISDA board, where we've added several buy-side firms as directors.

Greater inclusion of the buy-side is simply the right thing to do…and we'll be doing more of it as we move forward.

This brings me to my second point: the need to build a consistent global regulatory framework focused on systemic risk reduction

Needless to say, this is a huge challenge.

But we must rise to meet it.

As I noted, we absolutely support the G20's goals.

Mitigation of systemic risk by reducing counterparty credit risk and increased transparency are essential components of a more stable system.

The key focus of the developing regulatory framework is focused in this area; but ISDA does have a number of concerns with regard to certain regulatory developments.

Two areas of concern that I want to cover today are:

Inconsistency of rules between key regulatory jurisdictions, or Extra-Territoriality.

And the fact that certain regulatory initiatives are focused on market structure, not systemic risk reduction.

The costs and benefits of some proposals are not clear and have yet to be fully examined.

With regard to Extra-Territoriality, there are today large and growing concerns regarding the applicability of Dodd-Frank outside of the US.

These concerns have been raised by both US and non-US entities.

There is a great deal of uncertainty among market participants about whether and how to implement a new regulatory framework that may duplicate or conflict with that of their parent country.

Adding to the uncertainty are the new rules proposed by federal regulators on margin requirements

…. Requirements that include provisions regarding extraterritorial application of those rules

These rules would create significant issues for swap dealers affiliated with US holding companies

The extraterritoriality proposals are also inconsistent with Congressional intent.

Congress included provisions in Dodd-Frank that explicitly instruct regulators to impose the regulations outside the US only if there is a "direct and significant connection" with the US economy.

These provisions are intended to appropriately balance the protection of the safety of the financial system with the competitiveness of financial institutions, which is clearly necessary for a healthy banking system.

And this is a two way street. Disadvantaging foreign institutions and their US subsidiaries, through divergent capital requirements or otherwise, discourages foreign investment in US subsidiaries, which leads to fewer jobs and to reduced liquidity.

Such divergent treatment also creates the potential for retaliatory measures abroad, further reducing liquidity and competitiveness for both US- and foreign-based firms. And creating a fertile environment for regulatory arbitrage.

Extra-territoriality is a very real concern. Steps must be taken now to ensure that these concerns are properly resolved. Failure to address these issues now will have a real and direct impact on the US banking system. As I said, healthy banks are needed for a healthy economy, which impacts jobs and tax revenues.

Turning to the regulatory focus in the area of market structure.

ISDA's view is that too much time, resources and attention is being spent discussing, debating and formulating rules that don't center on meaningful risk reduction.

Why make changes unless we know what the benefits will be?

Or perhaps more importantly, what will be the unintended consequences in terms of increased risks and other costs?

Greater focus instead needs to be placed on ensuring a globally coordinated, properly phased regulatory approach…an approach that is centered on reducing systemic risks.

So what are we doing about all this?

How is ISDA trying to address all of the regulatory challenges that the OTC derivatives markets face?

Let me summarize our approach in two words. Constructive. Factual.

By constructive, I mean that we continue to be engaged with policymakers working with a pro-active, positive approach aimed at addressing the key systemic risk issues that have been raised.

Clearing, compression, collateral, data repositories: these are the tools for reducing counterparty credit risk and we are hard at work on all of them. This work is being conducted in partnership with global regulators.

An example of great progress lies in the date repository area.

With the CDS trade warehouse up and running, risks such as those related to AIG as a counterparty will no longer be allowed build up unnoticed in the financial system.

AIG simply should not happen in the future. This is very real and constructive progress.

By factual, I mean that we are undertaking research that explores and quantifies the impact of proposed regulations and changes.

This ranges from the basic, such as comparing the structure and trading volumes of OTC versus exchange traded markets, to more in-depth analysis.

The OTC and exchange traded markets are very different.

One is a high volume market with many small trades executed by thousands of counterparties.

The OTC market, by contrast, has much smaller volumes, with many fewer market participants, but much larger trade sizes.

The facts serve to inform and educate the debate – there is no one-size-fits-all set of regulations that can be applied to both OTC and Listed Derivatives.

At the opposite end of the research spectrum is Professor Craig Pirrong's paper on clearing.

It's a thorough and thoughtful exposition that examines the key issues related to central clearing.

I'm very glad that Professor Pirrong is here with us today. We will be hearing more on this later.

Our constructive, factual approach marks a new phase in ISDA's support for the derivatives markets.

With this approach, I believe it's time for the industry to begin to look past the financial crisis ….. to the future of our markets.

We should, and indeed we do, understand and accept the role that derivatives played in the financial crisis.

It was a fairly limited role.   Associated with too much interconnectivity of risks and a lack of transparency about exposures.

And as I have stated clearly,   we are well on the way to eliminating these risks.

Let me conclude:

Today, we are in the midst of a very complicated effort that may vastly change the financial markets.

It is, in a way, similar to the task that our predecessors faced some 25 years ago when ISDA was formed and the industry was in its infancy.

We, like they, have an opportunity to shape a market that is one of the most dynamic the financial world has ever seen.

We, like they, have a decision to make about whether we should engage each other and policymakers in this effort, or whether we should leave that work to others.

We, like they, have to achieve all of this in a difficult environment, one in which there is a significant level of misunderstanding about our markets.

We know what their decision was 25 years ago.

They took up the task at hand and helped build a market that changed the face of finance.

And I know what our decision will be today.

It will be to join together, once again, to work towards Safer, More Efficient markets.

Your attendance here today – and your continuing support of ISDA – underscores this commitment.

And I thank you very much for your support.

Thank you.

It's now my great pleasure to introduce our keynote speaker, Commissioner Scott O'Malia of the Commodity Futures Trading Commission.

Commissioner O'Malia has served in his current role for newly two years, and during that time he has consistently demonstrated an understanding of how markets function most effectively.

He has also invested a great deal of time with market participants from all camps to better develop his understanding of the issues and to inform his decision making.

We are very happy that he continues to play an active, visible role at the CFTC as the agency works on its rule-making process.

Before joining the CFTC Commissioner O'Malia served as a senior Senate staff aide, and worked in the private sector for Mirant Corp.

Please join me in welcoming Commissioner O'Malia to our Annual New York Conference.