



**Steps to a Vibrant and Resilient Derivatives Market
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**Remarks at the Mediterranean Partnership of Securities Regulators
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Good afternoon and thank you to the Mediterranean Partnership of Securities Regulators (MPSR) for inviting me to deliver remarks to such a distinguished audience.

This is a very valuable coalition of regulators that promotes cooperation and stability across EU and Mediterranean countries. We welcome the recent launch of the ambitious Pact for the Mediterranean and will be ready to support the market-related initiatives in cooperation with the International Organization of Securities Commissions.

This has been a fascinating event that speaks to some of the key challenges and opportunities confronting financial markets, from the green transition to the rise of artificial intelligence and digital finance. There is no doubt that big changes are coming, and we need to be ready.

At ISDA, we're no strangers to change. We're now coming to the end of our 40th anniversary year, and we've been reflecting on our journey since 1985, when a small group of dealers first got together to develop common standards for the derivatives market. We've spent the past 40 years responding to continuous changes in the products, the participants and the regulatory framework.

We've campaigned relentlessly for the enforceability of close-out netting in jurisdictions around the world – an absolutely fundamental step in the development of vibrant and resilient derivatives markets. By allowing counterparties to compress their obligations to a single net payment from one party to another in the event of a default, netting drastically reduces credit risk, which, in turn, increases liquidity and credit capacity. Many jurisdictions have opted to use the ISDA Model Netting Act as the basis for their legislation, and ISDA has now published more than 90 netting opinions, giving international firms the confidence and certainty they need to increase their participation in those markets.

Let's take three other examples where ISDA has worked hand in hand with regulators to respond to seismic market changes.

First, the retirement of LIBOR, a benchmark that once underpinned trillions of dollars of financial contracts. When policymakers called time on the benchmark and asked market participants to transition to alternative reference rates, many said it couldn't be done without major disruption. Following a multi-year effort that required painstaking preparation in close

collaboration with the public sector, ISDA launched contractual fallbacks in 2020 that helped pave the way for the safe removal of LIBOR.

Second, the implementation of margin requirements for non-cleared derivatives. When this was added to the post-crisis reform program, it was clear it would be a huge operational undertaking, especially as the scope of the rules extended to smaller entities over time. We developed the ISDA Standard Initial Margin Model (ISDA SIMM) so that market participants would have a common methodology for the calculation of margin, reducing costs and the potential for disputes. The ISDA SIMM is now used by hundreds of entities around the world, and we've worked closely with policymakers to ensure it remains appropriate and effective in all market conditions.

Finally, the framework for bank resolution. When policymakers introduced resolution regimes that would temporarily suspend the right to terminate trades with a bank under resolution, they needed a watertight mechanism to ensure this kind of stay would be enforceable in a cross-border context. We developed the ISDA Resolution Stay Protocol, under which adherents opted into the stay provisions of overseas resolution regimes, delivering the legal certainty that was needed to properly resolve the 'too big to fail' problem.

In each of these cases, ISDA worked tirelessly to develop robust solutions that enabled change. The challenges were neither simple nor easy to resolve – they required ambition, commitment and collaboration with regulators. As we look to the future, it's clear that a similar approach will be needed to overcome the challenges and harness the opportunities that are coming. We've learned from our 40-year track record that while the issues change, the process endures.

I want to use these remarks to talk about several areas where ISDA is now focusing its efforts to enable positive, meaningful and lasting change and to maintain vibrant and resilient derivatives markets. These include the global capital framework, collateral management, regulatory reporting and carbon market development.

Capital

I'll start with capital.

Over the next few years, implementation of the Basel III framework is due to be completed in key jurisdictions. This is the last major set of reforms to the global capital framework, and includes the Fundamental Review of the Trading Book (FRTB) market risk rules. The preservation of vibrant and resilient markets depends on appropriate, risk-sensitive capital requirements, so we must get this right. If we fail, we'll see reduced access to funding, a lack of hedging solutions and increased vulnerability to external shocks.

When we scrutinize proposed rules and recommend targeted changes, it is always with the aim of making sure capital requirements are appropriate for the underlying risks. We also believe the rules should be as consistent as possible across borders. A lack of alignment creates added complexity for globally active banks, making it more difficult for them to effectively manage their risks and service their clients.

As it stands, there is fragmentation between the major jurisdictions, both in the timing and content of the rules. In the US, regulators are revising the Basel III endgame proposal in light of industry feedback, and we expect to see a new proposal in the coming months. In the EU and the UK, the FRTB is currently due to be implemented from the start of 2027, but the UK Prudential Regulation Authority has proposed delaying the rollout of internal models until the following year. Meanwhile, the European Commission is consulting on a set of temporary changes to the FRTB that would bring some short-term relief. We're working with our members to respond to that consultation, but, as a general principle, we believe it would be preferable to develop solutions that ensure lasting risk sensitivity.

One of the key features of the FRTB is a much more stringent testing and approval process for banks that want to use internal models. Last year, an ISDA survey found that only 10 out of 26 global banks plan to use internal models for a much-reduced scope of trading desks under the FRTB. That's a big change that would mean less alignment between risk and capital and less diversity in models and behavior. It could lead to herd behavior and drive concentrations in particular assets. While the FRTB standardized approach is designed to be more risk-sensitive than previous iterations, its calibration will inflict the highest capital increases on those banks with large, diversified portfolios.

We must make sure there is a future for internal models, which means revisiting the rules. ISDA has recommended changes to improve the incentives to use internal models, which include the recalibration of certain elements of the FRTB, including the profit & loss attribution test, the risk factor eligibility test and non-modellable risk factors.

I'm pleased to say we've had very productive engagement with policymakers in recent months, particularly in the US. We're hopeful that the revisions to the Basel III endgame will make internal models a more viable option than in the original proposal. Once the revised proposals are published, ISDA will work with its members to evaluate the calibration and test the impact to ensure we achieve a capital framework that is truly risk-appropriate and fit for purpose.

We're also engaging with policymakers on the Basel Committee's prudential standard for crypto-asset exposures, which is scheduled to be implemented from January 1, 2026. In its current form, this standard would impose overly conservative and punitive capital requirements that do not accurately reflect the risks of crypto assets and would be inconsistent with established market risk practices. Earlier this year, we joined with other trade associations in calling for a pause and recalibration, and we welcome the Basel Committee's recent announcement that it would undertake a review of targeted elements of the standard.

Financial markets are moving rapidly to adopt powerful technologies like tokenization, which could bring significant advances in efficiency. It is vital that disproportionate capital requirements don't hinder those efforts, so we will continue to advocate for greater risk sensitivity in the capital treatment of crypto-asset exposures.

Collateral

I'll now turn to one particular area where we're working hard to realize the benefits of tokenization – collateral management.

With markets becoming ever faster and smarter, we're seeing growing momentum behind the shift to 24/7 trading. But if markets are to remain vibrant and resilient, the risk management infrastructure will need to catch up. There are still far too many bottlenecks and inefficiencies in our existing systems and processes to accommodate 24/7 trading.

Collateral management is a case in point. As I mentioned at the start of these remarks, the ISDA SIMM has provided a robust and transparent methodology for market participants to calculate margin requirements for non-cleared derivatives. Collateral has helped to mitigate counterparty risk in the derivatives market, but the financial system has become increasingly prone to liquidity crunches during periods of stress. As margin calls spiked, many firms struggled to meet their obligations because of the continued reliance on manual intervention and a lack of interoperability across internal systems and with external parties.

It is critical that firms have sound liquidity risk management, liquidity stress testing, resilient operational processes and sufficient levels of cash and liquid assets to meet their margin calls. But it's also vital that the collateral gets to where it needs to be quickly and efficiently.

In response, ISDA has developed suggested operational practices for collateral management. We've also used the Common Domain Model (CDM), a standardized data and process model, to digitize key documents, represent eligible collateral terms and automate cash collateral calculations and payment processes.

Tokenization also has a part to play in modernizing the collateral management infrastructure. For example, it could help to alleviate the workflow challenges by enabling near-instantaneous settlement of collateral transfers. We're also exploring how tokenization might help firms to use a wider range of eligible assets as collateral.

Market participants are increasingly looking to use non-cash securities for margin, but there are certain economic, capital and operational constraints that prevent some counterparties from holding anything other than cash or government securities. For example, money market funds would have to be liquidated and posted as cash and then transformed by the custodian, which can lead to increased liquidity and operational risks.

Once tokenized on a shared ledger, money market funds could be much more efficiently mobilized as collateral. Shares of a fund could be directly posted and returned without the need for liquidation within the collateral management process.

ISDA is now engaging with experts across financial markets to identify and address certain legal, regulatory and operational challenges to enable the adoption of tokenization. We're focusing on two key areas. First, we'll work with the official sector to establish clear and consistent legal and regulatory frameworks to bring certainty, enable cross-border adoption and improve market confidence. Second, we'll aim to establish interoperability, underpinned by common data

models, smart contract standards and messaging protocols, to reduce fragmentation, lower integration costs and enable cross-platform connectivity.

There's no doubt that tokenization has real potential to improve the timeliness and efficiency of collateral management, increasing the vibrancy and resilience of derivatives markets. That's why we're focused on helping to realize its potential.

Data reporting

The completion of Basel III and the introduction of an effective legal and regulatory framework for tokenization will only be successful with continued engagement and collaboration between the public and private sectors. The same is true of another of the post-crisis reforms – derivatives data reporting.

It's no secret that this has been one of the most difficult reforms of all and, despite repeated efforts, we haven't yet got it right. The original mandate from the G-20 to report trades to designated repositories made a lot of sense in the wake of the financial crisis. The dangers of opacity had just been laid bare, and regulators clearly needed a more effective way to identify emerging risks before they threatened market stability.

I was a commissioner at the Commodity Futures Trading Commission (CFTC) when the US rules were drafted, and it was clear that reporting would only work if we managed to implement the rules consistently around the world. Without global consistency, we'd have a patchwork of fragmented data that would be of very little use to the public sector.

Unfortunately, that consistency never materialized. Every jurisdiction took its own approach, with little alignment in what was reported from one market to the next, making it very difficult to reconcile cross-border trades. In some cases, multiple rules in a single jurisdiction meant firms had to report the same trade several times, leaving regulators trying to make sense of duplicative information.

With inaccuracies, repetition and omissions in what is reported, and privacy rules preventing the sharing of data, regulators don't always have the information at their fingertips to enable them to identify the build-up of derivatives exposures and risks. It may exist in some form within trade repositories, but it's not always easily accessible. As ISDA put it in a paper in 2023, the information regulators need is often "hidden in plain sight".

Policymakers are well aware of these problems and want to address them. Earlier this year, the European Securities and Markets Authority (ESMA) sought industry feedback on the major cost drivers associated with reporting, in an effort to establish how the reporting burden in the EU could be reduced and simplified.

We welcome this initiative and believe a key part of any solution should be a holistic review of the EU's multiple reporting regimes to clearly identify what information regulators really need. As it stands, trade reporting is required under three separate rulebooks – the Markets in Financial Instruments Regulation (MIFIR), the European Market Infrastructure Regulation (EMIR) and the

Securities Financing Transactions Regulation (SFTR) – and there are many instances where the same transaction has to be reported under multiple regulations. This is not only unnecessary – it also creates an additional burden on regulators to reconcile duplicative reports.

A holistic review of reporting rules under these three regulations would pave the way towards a single regime that optimizes reporting and enhances its value for the public sector, while reducing the burden for the market. A single EU reporting regime would comprise only the relevant data fields without duplicative or unnecessary reporting, requiring firms to deliver a single transaction report to meet their obligations under the current MIFIR, EMIR and SFTR regimes.

The good news is that ESMA's call for evidence included some very constructive proposals that would help to reduce these costs and improve the quality of reported data. For example, the removal of the dual-sided reporting model and the clear delineation of reporting by instrument type would simplify processes, reduce the number of reports and avoid mismatches in what is reported.

We welcome ESMA's engagement on this important issue and look forward to further progress next year. We also welcome the UK Financial Conduct Authority's new consultation on a set of proposals to improve transaction reporting under UK MIFIR. This is part of a long-term strategic approach to streamline transaction reporting requirements across multiple regimes. We're working with our members to analyze the proposals and develop a response.

Of course, creating an effective global reporting framework means working across borders in pursuit of consistent, appropriate rules. Over the past three years, regulators around the world have updated their reporting rules to incorporate globally agreed data standards and bring greater consistency to their reporting regimes. Starting with the CFTC in December 2022, we now have updated reporting rules in eight jurisdictions, with Hong Kong being the latest to implement changes in September. That's a very welcome step forward and ISDA has been working hard to help market participants implement the rules in a uniform way that properly reflects what is required.

In 2022, we launched the Digital Regulatory Reporting (DRR) initiative, which converts an industry-agreed interpretation of multiple reporting rule sets into machine-executable code using the CDM. Users can take this code as the basis of their implementation or use it to validate their own interpretation of the rules. The ISDA DRR has yielded massive efficiencies and improved the accuracy of what is reported – an important consideration, given nearly \$300 million has been paid in fines for misreported data in the US, UK and EU. The DRR has so far been adapted to all eight sets of updated reporting requirements, and we've committed to supporting 12 core reporting regimes across nine jurisdictions.

Carbon markets

Before finishing, I'll briefly touch on one more area where we need continued collaboration to realize progress – the development of a vibrant and resilient global voluntary carbon market.

We must never lose sight of the important role carbon markets can play in channeling the capital that is needed to achieve the transition to net-zero. Following last year's agreement to establish a UN-backed carbon market under Article 6 of the Paris Agreement, recent negotiations at COP30 focused on implementation. ISDA is fully supportive of these efforts, and we've shared our recommendations with policymakers on the vital steps we believe are needed to enable the voluntary carbon market to reach its full potential.

First, we need a globally consistent definition of a ton of carbon that is adopted by all market participants. This must be accompanied by an independent, science-based system to verify and audit the soundness and integrity of voluntary carbon credits. Second, we need a robust legal framework to create greater certainty and confidence. Third, we need a liquid forward market, which will provide valuable signals as the market evolves. Finally, we need a globally consistent regulatory framework to create the clarity companies need to trade and invest.

ISDA is working hard to provide legal certainty for this market. To sustain deep and liquid secondary markets, create clear price signals and allow funds to be efficiently channeled to emissions-reducing projects, the legal treatment of carbon credits must be properly defined. We set out the steps needed to create greater legal certainty in a series of whitepapers, and we're making good progress.

The International Institute for the Unification of Private Law (UNIDROIT), an intergovernmental institution, is now in the final stage of developing critical guidance on the appropriate standards to ensure bankruptcy treatment and the exchange of security are properly defined, and the rights of holders are protected. This guidance will provide a common legal baseline for carbon trading, and ISDA will advocate for countries to incorporate the principles when drafting rules for these markets.

The UNIDROIT guidance will build on the foundations we established with the ISDA Verified Carbon Credit Transactions Definitions, which created a single contractual framework for the trading of these contracts. Last year, we updated the definitions to incorporate the Core Carbon Principles developed by the Integrity Council for the Voluntary Carbon Market, and we recently published the latest iteration that includes standards from the Carbon Offsetting and Reduction Scheme for International Aviation.

These are positive steps in the right direction, and we will continue to engage with policymakers to build confidence in the voluntary carbon market through strong and consistent standards.

Conclusion

I started these remarks by reflecting on some of the big industry challenges that ISDA helped to solve over the past decade. In each case, from LIBOR and initial margin to the bank resolution framework, the challenge at times seemed insurmountable – too big, too complex to overcome. But we never gave up. We showed that with ambition, commitment and collaboration, nothing is impossible.

I've talked about some of the key areas where we're now focusing to ensure vibrant and resilient derivatives markets – capital, margin, reporting and the voluntary carbon market. These are also complex, thorny issues, but I'm confident the same approach we've used in the past will once again succeed. It's a full book of work, and we need ambition, commitment and collaboration with the public sector. So, let's make it happen.

Thank you.