ISDA Safe, Efficient Markets

ISDA/SIFMA AMG Derivatives Trading Forum:
The Path to Resilient Treasury Markets
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Good morning everyone and welcome to the Derivatives Trading Forum. First, let me thank CME Group, our founding sponsor, for helping us get this event off the ground. We really appreciate your support. I'd also like to thank SIFMA AMG for its partnership on today's forum.

Last week marked the one-year anniversary of the US Securities and Exchange Commission's (SEC) proposed Treasury market amendments – proposals that would, among other things, require Treasury clearing houses to compel their members to clear certain cash Treasury securities and repos.

Over that 12-month period, market participants have been thinking hard about the various implications and consequences. The US Treasury market is the beating heart of the global financial system, and any change will reverberate across markets, including derivatives and collateral management.

It's therefore critical we get this right. ISDA's mission is to foster safe and efficient derivatives markets. To achieve that, we need a Treasury market that functions effectively and is liquid and resilient, even during stress.

In my remarks this morning, I'll first briefly summarize the feedback on Treasury clearing we've had from our members and describe how we might be able to help the market implement any future rule. I'll also touch on the recent US Basel III 'endgame' proposals. I'll then turn to another area where ISDA is helping to bring greater efficiency to derivatives markets – by developing and innovating a suite of mutualized digital solutions.

Treasury amendments

The US Treasury market has seen extraordinary growth in recent years. The $24 trillion in outstanding issuance at the end of 2022 has roughly doubled over the past 10 years and is expected to rise to $46 trillion at the end of 2033, according to the Congressional Budget Office. That would equate to 118% of GDP, more than two-and-a-half times the 50-year average of 46%.

Despite the critical importance of this sector, there have been increasing concerns about capacity of the US Treasury market to function effectively during periods of stress – for instance, during the dash for cash in March 2020, when extreme selling pressure in the face of a global pandemic caused the market to seize up.

The SEC believes that increased clearing is part of the answer. Proponents say this will help reduce counterparty credit risk, increase transparency and balance sheet capacity, and open the way for smaller firms to act as liquidity providers. But it also comes with costs due to clearing fees, margin requirements and operational charges.

Ahead of the SEC proposal, ISDA conducted a survey to get industry input on the possible benefits and costs. Most respondents were generally supportive of clearing, highlighting a reduction in counterparty risk and the netting of exposures, which could ease the strain on dealer balance sheets.

However, some warned the costs associated with a broad clearing mandate could lead certain entities to reduce activity or withdraw from the market altogether.

Respondents also pointed to other changes that could be made to increase intermediation capacity at dealers and encourage clearing – for example, a permanent amendment to the supplementary leverage ratio calculation to exclude US Treasuries, a change that was made on a temporary basis by the Federal Reserve during the 2020 dash for cash.

It's not clear when the final SEC rule will be published, what the time frame for implementation will be, or whether there will be any phasing of the requirements. We'll engage closely with members when the rule is finalized and assist with implementation where we can.

One area where we can certainly help is the legal documentation. We spent years solving for the introduction of mandatory clearing in derivatives markets, which included the development of standard client clearing documentation.

As well as a potential clearing mandate, the SEC's September 2022 proposals aim to ensure broad access to clearing, including for indirect participants. We think we can bring our experience to bear here – both in terms of providing input on client clearing models and drafting appropriate documentation.

By helping to create a safe and efficient market structure for Treasuries, we can help to ensure a safe and efficient derivatives market.

US capital rules

Now, I mentioned the capacity of dealer balance sheets, so it seems an opportune moment to touch on the recent US Basel III proposal, published on July 27.

ISDA will run an industry quantitative impact study to obtain a detailed understanding of how the rules will affect banks, but US regulators estimate the latest changes will result in an aggregate 16% increase in capital requirements, with the increase falling mainly on the largest and most complex banks. That's despite the roughly 3.7 times increase in capital at US global systemically important banks since the 2008 financial crisis and the continued resilience of those banks through recent stress events.

We strongly believe capital rules should be risk sensitive and appropriate. Disproportionate increases in capital could force banks to curtail certain trading and intermediary businesses, creating further capacity issues and raising financing and hedging costs for end users.

Our industry study will give us detailed information on impact, and we intend to use that to engage constructively with regulators during the consultation period.

Digitization

Let me now turn to another big focus for ISDA, which we think will be instrumental in driving efficiencies and cost savings: the digitization of derivatives markets.

Financial markets have leant 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, 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.

A key part of our effort has been to digitize our legal documentation. Our 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 now 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 idea 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 want 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.