IQ In brief

ISDA held the first day of its virtual Annual General Meeting on May 10, with sessions on LIBOR transition, alternative reference rates, diversity in derivatives markets and the forthcoming introduction of the 2021 ISDA Interest Rate Derivatives Definitions

O'Malia: Pandemic has Accelerated Derivatives Digitisation

The coronavirus pandemic has triggered a digital revolution in the derivatives market, accelerating the move towards a more automated, fully digital operating environment, ISDA chief executive Scott O'Malia has said.

"While most of us will return to our offices, albeit on a hybrid basis, we must not forget that we have created a new model for working that puts far more emphasis on a fully digital environment. The world of paper and files is over, but we need to continue our journey towards a robust, fully digital financial system," he said.

Speaking at the opening of ISDA's 35th Annual General Meeting, O'Malia reflected on the lessons learned from the pandemic, in which the derivatives industry had to switch to operating remotely and everything had to be done digitally at a time of extreme market stress. The realisation that the market can function effectively when people are not physically located in their offices has led to a redoubling of efforts to build a digital future, he said.

"It's a future where the terms of every trade are captured electronically and fed directly through to trading, operational and risk management systems in a consistent way. It's an environment where electronic documents and definitions are easily accessible on a single digital platform. Where firms can access a golden source of data in digital form, and where a standard, codable taxonomy of products, events and processes enables alignment and automation across the lifecycle," said O'Malia.

Three key digitisation initiatives are bringing new efficiencies and savings to the derivatives market, said O'Malia: the Common Domain Model (CDM), the 2021 ISDA Interest Rate Derivatives Definitions, and ISDA Create.

The CDM is being deployed in multiple areas and has proven to be effective in improving the accuracy and alignment of derivatives trade reporting. Digital regulatory reporting using the CDM enables firms to interpret and implement reporting rules consistently through common, machine-readable code. It will also improve the integrity and comparability of what is reported, enabling regulators to get a clearer picture of trading activity and risk.

"During this period of disruption and hardship, we as an industry have taken an important step forward in our digital journey, and we plan to maintain momentum during the recovery"

Scott O'Malia, ISDA

"The CDM is becoming the lingua franca for derivatives, providing an unparalleled opportunity to achieve greater consistency across firms and systems, eliminating inefficiencies and reducing costs," said O'Malia.

As well as the 2021 Definitions (see page 5), O'Malia also pointed to the success of ISDA Create in enabling the electronic creation, negotiation and execution of critical documentation. Since it launched in 2019 with an initial focus on supporting initial margin documentation, the platform has expanded significantly with the recent addition of the ISDA Master Agreement.

"In the context of remote working, being able to manage documentation electronically has become more important than ever," said O'Malia. "During this period of disruption and hardship, we as an industry have taken an important step forward in our digital journey, and we plan to maintain momentum during the recovery."

Time to Put Foot on Accelerator of LIBOR Transition, Say Panellists

Continued publication of certain US dollar LIBOR settings until mid-2023 should not be interpreted as a delay, and firms should step up their efforts to prepare to use alternative reference rates for all new trades by the end of this year, according to speakers on a LIBOR panel at the start of this year's ISDA Annual General Meeting.

The UK Financial Conduct Authority (FCA) announced on March 5 that 30 LIBOR settings will either cease or become non-representative at the end of this year, while five US dollar LIBOR tenors (overnight, one month, three month, six month and 12 month) will continue to be published on a representative basis until June 30, 2023.

No new LIBOR

The mid-2023 end date means roughly two thirds of existing US dollar LIBOR exposure will roll off naturally, but US regulators have made clear they expect US-supervised entities to stop using US dollar LIBOR for new trades after the end of 2021, subject to a few exceptions. The UK FCA has also said it might restrict new use of US dollar LIBOR after end-2021 under proposed new powers set out in the Financial Services Bill, which is currently making its way through the UK parliament.

"The first thing to underline is that the LIBOR panel is going to end at the end of June 2023 for US dollars. It is not going to be extended. Even if a rate is produced on a synthetic basis for a time-limited period thereafter, it will not be representative after end-June 2023, and of course, it might not be published at all. But even before end-June 2023 – in fact, by the end of this year – the use of US dollar LIBOR, like the other LIBOR currencies, needs to stop in all new contracts," said Edwin Schooling Latter, director of markets and wholesale policy at the UK Financial Conduct Authority (FCA).

"Of course, people shouldn't drive at a faster speed than they can safely do so, but the time has come, I think, to put the foot down on the accelerator rather than take your foot off the pedal," he added.

Other regulators and national benchmark working groups are also rolling out their own deadlines for halting new use of LIBOR. For example, the Hong Kong Monetary Authority has set a deadline of December 31, 2021 for authorised institutions to cease entering new LIBOR contracts, including those referenced to US dollar LIBOR.

> "The first thing to underline is that the LIBOR panel is going to end at the end of June 2023 for US dollars. It is not going to be extended"
>
> **Edwin Schooling Latter, UK Financial Conduct Authority**

Even where firms are not directly affected by regulatory requirements, the ability to trade products linked to LIBOR after the end of 2021 will likely be affected as supervised banks pull back, said Schooling Latter.

"When an unregulated corporation makes a financial transaction, usually it is going to have a regulated firm on the other end of that transaction or arranging it for them, whether that's a loan or in the derivatives market. And, obviously, in that relationship, the regulated firm has a particular responsibility for explaining to the customer that LIBOR is coming to an end and it is time to be doing business on the new alternative risk-free rates," he said.

Liquidity in those risk-free rates (RFRs) has improved over the past year, particularly in established rates like SONIA. According to analysis by ISDA and Clarus, 44.9% of total cleared over-the-counter and exchange-traded sterling interest rate derivatives DV01 was linked to SONIA in March, up from 28.8% in March 2020. However, the proportion is lower in several other currencies, including US dollar. Just 4.7% of US dollar interest rate derivatives DV01 was referenced to SOFR in March.

Liquidity expectations

A variety of alternatives to US dollar LIBOR have emerged, including some with a credit spread component meant to reflect the dynamics of bank lending markets. However, Tom Wipf, vice chairman of institutional securities at Morgan Stanley and chair of the US Alternative Reference Rates Committee (ARRC), said he expects liquidity in SOFR to increase as the end-2021 deadline approaches.

"At the ARRC, we have a best practice that recommends people stop using new LIBOR after June of this year. So, between June and December, whether it be the best practice recommendation or the supervisory hard stop, we should see a pretty meaningful transition. And so, at that I point, I do think the driver will be liquidity and the markets will go to where liquidity is – which in the US will be SOFR," he said.

The FCA's Schooling Latter agreed that RFRs would likely dominate trading activity, highlighting the experience of SONIA in the UK. In particular, the wide adoption of new derivatives fallbacks based on RFRs means these rates will likely become prevalent after end-2021, he said. According to FCA calculations, more than 97.5% of outstanding sterling LIBOR derivatives will switch to SONIA compounded in arrears at the end of the year as a result of the fallbacks.

"Although I don't have complete and comprehensive and precise figures…I suspect the figure for US dollar is actually pretty similar. So that means close to 100% of that huge market is going to be based on SOFR. And I think anything else is looking at a pretty small niche around the edge," he added.

Liquidity Will Centre on RFRs, Panellists Say

Risk-free rates (RFRs) will see the lion's share of liquidity in the post-LIBOR world, but there are uses for alternative rates, including those with a credit-sensitive component, according to panellists at the ISDA Annual General Meeting.

A variety of credit-sensitive rates have emerged as alternatives to US dollar LIBOR, including AMERIBOR and Bloomberg's BSBY, as well as the forthcoming IHS Markit US dollar Credit Rate and the ICE Bank Yield Index. Speaking on a panel on liquidity in alternative reference rates sponsored by Murex, Sonali Theisen, managing director, head of FICC e-trading and market structure at Bank of America, said it is important to provide alternatives for those parts of the market that might struggle to adopt RFRs, such as loans.

"We think it is prudent to at least give the market choice and having a credit-sensitive option ready and available alongside SOFR is the smoothest thing for markets as we undertake this massive paradigm shift," she said, adding that this will likely help accelerate the transition away from LIBOR.

Speaking on the same panel, Jack Hattem, managing director, global fixed income, at BlackRock, agreed there will be some use cases for credit-sensitive rates and other alternatives like forward-looking RFR term rates, but stressed that liquidity will likely centre on SOFR in the US.

"As the majority of liquidity, we believe, will still be in SOFR, education becomes very important. So, you have to understand the construction of these alternative indices that involve a credit component – how are they made, what is the appropriate fit? And then what's the liquidity in those products and is there liquidity in derivatives for effective hedging purposes? Once you evaluate all of those, then you can decide what's the most appropriate for your portfolio," he said.

While there are no concrete plans to clear derivatives linked to credit-sensitive rates, Phil Whitehurst, head of service development, rates, at LCH, said this could occur in future if there is sufficient demand, and said the clearing house is sounding out its user base. "This is really going to be a dollar swap market that is very much SOFR-based in the future for pricing, discounting and valuations, so this is something that could be additional," he said.

In an audience poll question on post-LIBOR interest rates, 46% of the audience thought interest rate portfolios will primarily comprise RFRs with overnight index swap conventions but with a mix of RFRs with other conventions and other alternatives.

"It's clear there is this expectation that RFRs will largely be used for, I think, most uses and then there may be cases where some other form is beneficial. I think we could certainly see that particularly with corporates," said Chirag Dave, executive director, sterling rates trading, at Goldman Sachs. IQ

ISDA Protocol Has Helped to De-risk Market

The widespread adoption of the ISDA 2020 IBOR Fallbacks Protocol has significantly reduced the systemic risk posed by LIBOR ceasing or becoming non-representative, according to speakers on a LIBOR transition panel.

"With the huge uptake we've seen of the protocol and the wide adoption of it, I think there's been a big de-risking of the market risk piece of this puzzle across the derivatives market," said Tom Wipf, vice chairman of institutional securities at Morgan Stanley and chair of the US Alternative Reference Rates Committee.

The ISDA fallbacks came into effect on January 25, ensuring derivatives referenced to key interbank offered rates (IBORs) automatically switch to a fallback based on risk-free rates if an IBOR permanently ceases or, in the case of LIBOR, is deemed non-representative. More than 13,800 firms have so far adhered to the ISDA 2020 IBOR Fallbacks Protocol, which allows firms to incorporate the fallbacks into existing trades with other counterparties that also adhere.

Speaking on the same panel, Arthur Yuen, deputy chief executive of the Hong Kong Monetary Authority, said implementation of fallbacks had helped Hong Kong institutions take a big step towards preparing for LIBOR transition.

"After the adoption of the ISDA protocol, we have actually seen the amount of contracts that did not have adequate fallbacks dropped substantially by 86%, because 86% has been addressed by the ISDA protocol," he said.

With fallbacks now in place as a safety net, firms could increase voluntary transition in order to better tailor the economic terms of their contracts before any cessation event, added Wipf.

"What I suspect will be the next step is…for market participants to think about voluntary conversions and to think about where they'd like to be in terms of controlling the outcomes and not having to deal with a lot of this operational risk as we get to the end. So, I think an incredible amount of de-risking has occurred. I think the protocol itself has been a resounding success. And I suspect when we look across this, the next step will be moving to voluntary conversions to complete this transition," he said. IQ

Watch a short video on the ISDA fallbacks here: bit.ly/3eTqKij
The ISDA 2020 IBOR Fallbacks Protocol is available here: bit.ly/3ekUghL

IQ In brief

Regulators Explore COVID Lessons

A variety of regulatory workstreams are under way to explore the implications of market stress caused by the coronavirus crisis last year and to understand if policy responses may be necessary, according to Ashley Alder, chair of the International Organization of Securities Commissions (IOSCO) and chief executive of Hong Kong's Securities and Futures Commission.

As the coronavirus outbreak developed into a pandemic in March 2020, there was a sudden scramble for cash from corporates and investors, which caused strong selling pressure across asset classes and extreme market volatility. Faced with a squeeze in liquidity, central banks pumped trillions of dollars into the financial system to stabilise the situation.

While markets continued to function, there are several areas that warrant examination to better understand what happened, said Alder, speaking in a keynote address on the first day of ISDA's Annual General Meeting.

One area of focus is the resilience of non-bank financial institutions (NBFIs) during periods of stress. IOSCO and the Financial Stability Board are looking at liquidity and redemption pressures in investment funds, and a consultation on NBFI resilience will be issued in the coming months. In particular, work is under way to explore policy options "to address potential vulnerabilities in money market funds that could affect financial stability", Alder said.

"An overriding consideration is how to ensure that these NBFI activities are sufficiently resilient, but to do so in a way which does not stifle investment flows and hence their contributions to the real economy, especially during times of stress," he added.

IOSCO is also working with the Basel Committee on Banking Supervision and the Committee on Payments and Market Infrastructures to review the spike in margin requirements during March and April 2020. While central counterparties and other financial market infrastructures remained resilient during the crisis, volatile markets resulted in sharp increases in initial and variation margin, raising concerns about procyclicality.

"In some cases, initial margin requirements increased more than 100%. So, our work will examine whether margin behaviour during such an extreme scenario teaches us anything that may need to be factored into the regulatory framework. One concern is whether sudden changes in margin rates can have strong procyclical effects, particularly if previous margin models did not sufficiently account for extreme scenarios," said Alder.

The study will focus on initial and variation margin requirements in both cleared and non-cleared markets during the crisis, Alder said.

"Throughout the exercise, we will of course bear in mind the exceptional nature of last year's shock – one that originated outside the financial system and which raised the prospect of a sudden stop in economic activity," Alder said. IQ

Cooperation on Climate Change Critical, Says Behnam

International coordination and harmonisation will be vital if countries are to meet their targets to cut carbon emissions and shift to a greener economy, according to Rostin Behnam, acting chairman of the US Commodity Futures Trading Commission (CFTC).

Speaking during a fireside chat on the first day of the ISDA Annual General Meeting, Behnam said not working together would be self-defeating and would mean countries struggle to meet their goals to tackle climate change.

"This is not a regional issue – this is not an issue that's limited to one country or geography. We have to make sure the entire world is working off the same page," said Behnam.

Last September, the CFTC's Climate-related Market Risk Subcommittee of the Market Risk Advisory Committee published a landmark report on managing climate risk in the US financial system. A key recommendation was the establishment of a transparent and resilient carbon market – a development Behnam stressed was critical to the success of the transition.

Carbon emissions are currently a costless by-product of fossil fuel production, he explained. "As long as it's costless, financial markets and the consumer value chain, from energy producers to consumers, are not going to move away from carbon-emitting energy soon enough. And so, the idea is that if we can put a price on carbon – basic economics – allocation of capital will move away from it, consumers will move away from it, and we can speed up the transition to a different renewable energy source."

Stressing that the development of an effective carbon market in the US would require congressional action, he nonetheless said regulators like the CFTC have an important role to play in encouraging the transition to a greener economy. That includes introducing regulatory requirements like mandatory disclosure and stress-testing regimes, but also encouraging innovation.

"We really need to work from a regulatory perspective with our stakeholders, both here in the US but also globally, to help incentivise different innovations and developments in the climate space so we can smooth out the transition and reduce the transition risk," said Behnam. IQ

IQ In brief

ISDA 2021 Definitions Due for October Implementation

ISDA is targeting implementation of the 2021 ISDA Interest Rate Derivatives Definitions over the weekend of October 2/3, with the new definitional booklet for cleared and non-cleared interest rate derivatives due to be published within weeks.

Speaking at the opening of the 35th Annual General Meeting, ISDA chief executive Scott O'Malia described the new definitions as the "next step" in ISDA's digital journey, explaining that this will be the first natively digital definitional booklet. To improve efficiency, a user platform is being developed that will allow market participants to access the definitions electronically, with enhanced navigation and other features.

"Rather than publishing supplements in paper or PDF form to reflect changes in regulation or market practice, ISDA will be able to revise and update the definitional booklet in full each time an update is needed. In fact, ISDA will stop publishing supplements for the 2006 Definitions altogether from the third quarter of this year," said O'Malia.

The 2021 Definitions will also incorporate vital updates to reflect the many changes that have occurred since 2006. This includes changes to cash settlement provisions, the role of calculation agents and descriptions of floating rate options.

"For both the buy side and the sell side, parties need to get used to the new technology, which is a huge benefit to both sides, as opposed to having to read through the ISDA website to look for supplements. The digital format is going to be very helpful. Parties have to be prepared for the fact that they will need to provide certain notices, and they have to get used to the new terms, fallbacks, conventions and matrices in the book," said Ilene Froom, partner at law firm Reed Smith, speaking during a panel on the 2021 Definitions.

When the definitions were last updated in 2006, market participants transitioned gradually at their own pace over a period of around 18 months. But in today's more interconnected market, it will be more important that firms coalesce around a single transition date as far as possible, said Jonathan Martin, director of market infrastructure and technology at ISDA.

"The market has chosen an adoption date for the 2021 Definitions of October 4, 2021. This date was really chosen to give firms a sufficient amount of time from the finalisation of the definitions to when they need to start using it in their contracts. That should give people four or five months to make the changes to their systems and processes they need to make. This will also be the date that major central counterparties and trading venues switch to defaulting to the 2021 Definitions," said Martin. IQ

Find out more about the 2021 Definitions: bit.ly/3usLgwx
Watch ISDA's animation on the 2021 Definitions: bit.ly/2SJDUXP

Time to Normalise Flexible Working, Say Speakers

The experience of flexible working during the coronavirus pandemic provides an ideal opportunity to build a more inclusive workplace that is not based on long working hours or being physically located in the office, according to senior derivatives practitioners.

"The pandemic has shown that we can work in hybrid environments – it has been challenging but we have all adjusted. I do believe we can create and build an inclusive culture for the future. Now is the time for firms to embrace policies that make it more attractive for women at all levels to remain in the workforce, and I think firms need to keep an open mind," said Tracey Jordal, executive vice president and head of Europe, the Middle East and Africa operations and trade support at PIMCO and chief executive of Women in Derivatives.

Panellists agreed that progress has been made in improving gender equality in the workforce, but said more needs to be done to promote inclusivity and ensure female voices have equal influence.

"I have been in a lot of rooms that are predominantly filled with men, and I find that often our objectives are aligned but my approach to solving the problem is different. Unfortunately, sometimes these differing approaches result in men and women talking past each other," said Dawn DeBerry Stump, commissioner at the US Commodity Futures Trading Commission.

"This is where we have to do more work," she added. "We worked hard to get a seat at the table and now we have to work hard to make our voices heard. We have to find our voice and make the contribution worthwhile, because just sitting at the table is not the endgame. Our objective here is diversity of thought and everybody needs to keep their eye on that ball." IQ

IQ In brief

At the AGM Today

3:00 PM **HKT** 4:00 PM **JST**	Opening Remarks *Scott O'Malia*, Chief Executive Officer, ISDA
3:10 PM **HKT** 4:10 PM **JST**	Dealing with a Multi-rate Regime Japan, like several other jurisdictions in Asia-Pacific, has opted for a multi-rate approach to benchmark reform, with the alternative risk-free rate co-existing alongside the local IBOR. With the timetable for the end of yen LIBOR now set, will TIBOR, TONA or the forward-looking term rate version of TONA (TORF) gain most traction? What impact will this have on market dynamics and liquidity?
4:00 PM **HKT** 5:00 PM **JST**	Break and Virtual Networking
4:10 PM **HKT** 5:10 PM **JST**	Developing China's Derivatives Markets Enforceability of close-out netting has long been number one on the wish list for derivatives participants active in China. What progress has been made – and what's next on the industry's wish list? **Panel Sponsored by DBS**
5:00 PM **HKT** 6:00 PM **JST**	Session Break
8:00 AM **EDT**	Virtual Networking
8:45 AM **EDT**	Chairman's Remarks *Eric Litvack*, ISDA Chairman, Group Director of Public Affairs, Société Générale
9:00 AM **EDT**	Keynote Address *Commissioner Mairead McGuinness*, European Commissioner, Financial Services, Financial Stability and Capital Markets Union
9:25 AM **EDT**	Margin – Widening the Net Firms have an overwhelming amount of work to prepare for phases five and six of the initial margin requirements for non-cleared derivatives, including getting their documentation in place and establishing custodial relationships. But broader issues also need to be addressed, including the margin calculation and call process, collateral eligibility and optimisation, and dispute resolution. How are firms progressing with their preparations for phase five of the margin rules, and how are regulatory requirements driving operational efficiencies and use of digital negotiation tools? **Panel Sponsored by SMARTSTREAM**
10:10 AM **EDT**	Break and Virtual Networking
10:15 AM **EDT**	ESG and Derivatives Markets Environmental, social and governance (ESG) issues are top of mind today, with policy-makers, industry groups, market participants and others engaged in initiatives ranging from disclosure to climate risk analysis to carbon trading. What is the current direction of travel for these and related developments? How are different jurisdictions approaching them and what are the prospects for a global consensus? How are derivatives markets affected by and adapting to the transition to sustainable economy and financial system?
11:05 AM **EDT**	Keynote Interview *Daniel Pinto*, Co-President and Chief Operating Officer, JPMorgan Chase and CEO, Corporate & Investment Bank, JP Morgan talks with ISDA CEO Scott O'Malia about the challenges and opportunities in financial markets.
11:30 AM **EDT**	Break and Virtual Networking
11:45 AM **EDT**	**SESSION A** Taking Action on Collateral Management Transformation There is significant scope to transform the collateral management process through operational improvements, data standardisation and automation. This panel will set out the steps firms can take to realise those improvements, and explore how standards (Common Domain Model) and digital tools (like ISDA Create) can help produce efficiencies.
	SESSION B CCPs Under Stress: COVID, Auctions and Recovery & Resolution CCPs passed a stress test in 2020 during the COVID crisis. What did coronavirus tell us about central counterparty risk management frameworks? Are changes necessary? On the regulatory front, where is the discussion on auctions and recovery and resolution?
12:30 PM **EDT**	Board of Directors Election / Financial Report **MEMBERS ONLY**
12:30 PM **EDT**	Virtual Networking and Exhibition
1:30 PM **EDT**	End of Day 1

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