2021 ISDA Regional Events

Opening Remarks

Scott O'Malia, ISDA Chief Executive

Hello everyone.

It seems, at long last, that life is slowly returning to some form of normality after 18 months of the pandemic. I'm now back in the office most of the week, I've taken my first business trips, and I've met with numerous ISDA members face to face.

It's reminded me just how important connections and interactions like these are. While we must remain cautious and alert, I'm optimistic that we'll be in a much better place in 2022.

But despite the pandemic, our agenda hasn't slowed down. In fact, we've been able to deliver on a huge volume of critical solutions, products and policy responses.

These include benchmark fallbacks, our first ever natively digital definitions, a new digital documentation platform, phase-five implementation of the initial margin rules and an update to the ISDA SIMM.

On top of this, we've our extended our focus to ESG, with the aim of developing standards, legal documentation and best practices for carbon, and other ESG-related derivatives.

We have also established a new working group to consider the legal and documentation issues related to crypto derivatives. This is exciting new work, and I'm looking forward to engaging with the crypto community as we unpack the unique aspects of this market.

In my remarks today, I'd like to focus on three of those issues:

- ESG;
- Benchmark reform and the impending death of LIBOR; and
- Our digital and crypto initiatives.

I'll start with the important work to transition to a green economy.

Financial markets will play a critical role here by mobilizing the estimated $110 trillion in capital needed by 2050 to invest in renewable energy and infrastructure, as well as helping companies to manage their risks.

Broadly speaking, there are four key drivers.

- The shocking and catastrophic weather events across the globe that are forcing us recognize and address the impact and risk of climate change.

- The commitments by governments to reduce emissions. Even ahead of the forthcoming COP26 climate summit, more than 130 jurisdictions have now pledged to reduce carbon emissions to net zero by 2050.
- Voluntary commitments by companies to cut emissions and meet a variety of sustainability and development goals.
- Strong interest by asset managers, pension schemes and others to invest in green assets.

Together, this has driven rapid growth in ESG-related financing, investments and hedges. But as volumes continue to climb, industry standards and best practices need to keep pace to ensure this market functions safely and efficiently. This is where ISDA is putting its focus.

A critical component of a successful transition to a green economy will be the development of a transparent and resilient carbon market. Establishing a realistic price on carbon will spur development of climate-related financial products and provide more transparent pricing of climate-related financial risks. Both are vitally important in driving investments towards new low-carbon technologies and infrastructure.

Regulated emissions trading systems are already up and running in several jurisdictions, and work is under way to complement these initiatives by developing a framework for a scalable voluntary carbon trading market.

Now, there have been some questions raised about the need for carbon trading, with a suggestion that it's a way to avoid behavioral change by simply buying up credits. We believe it will be very difficult to achieve transformational change without a voluntary market, but we recognize the need for carbon credits to be very clearly and strictly defined. This will ensure the market scales safely and efficiently, without the risk of greenwashing.

The Taskforce on Scaling Voluntary Carbon Markets was established last year and has made rapid progress in providing the necessary governance to ensure we have transparent and robust standards for the verification of carbon credits.

ISDA has contributed actively to the work of the Taskforce by promoting the importance of a solid legal foundation for carbon credits. We are now developing a paper to address certain legal and documentation issues that need to be tackled before contractual terms can be drafted and will then work to support the development of robust documentation templates.

This brings me to ISDA's role in promoting the legal framework, standards, and best practice, which will be critical to support the transition to a green economy.

We have already published documentation templates to support the trading of emissions and certain types of environmental derivatives. These include US, UK and EU emissions annexes and a US renewable energy certificate annex. As green financing grows, we will continue to work with members to identify areas where standard terms, documents and definitions are required.

Robust standards are also critical in any nascent market. Over the past two years, we have seen the emergence of a new breed of sustainability-linked derivatives that link cashflows to certain sustainability objectives, using key performance indicators to track compliance.

ISDA has been closely following the evolution of this market, but we recognize it will be impossible to scale without standards. To that end, we have developed a set of guidelines to promote the use of KPIs that are measurable, verifiable, and transparent.

We are also acutely aware of the need to ensure green instruments are treated appropriately in the regulatory and accounting frameworks, and we have published papers on both topics – one recommending solutions to issues associated with the US accounting treatment of ESG transactions and another analyzing the impact of carbon credits under the FRTB.

Reaching net zero is going to require every sector, every company, and every individual to play its part. That’s why ISDA is committed to supporting the transition across multiple fronts. You can count on us to continue this important work in the years and decades to come.

Benchmarks

Climate change is a topic that will dominate our markets for some time, but there are other, more immediate issues we must deal with as well.

Benchmarks are arguably the most pressing. We are now just over two months away from the end of 2021, the point at which 30 LIBOR settings will either cease or become non-representative. This deadline has been looming on the horizon for the past four years, and a colossal amount of work has gone into preparing for a smooth transition to alternative reference rates.

While five US dollar LIBOR settings will continue to be published until mid-2023, regulators have made clear they should not be used after the end of this year except in limited circumstances. So there really is little time left until market participants need to have moved away from LIBOR altogether.

In recent months, we have seen a marked increase in trading of alternative reference rates as market participants have stepped up their transition efforts. In particular, trading in SOFR and TONA rose significantly after ‘RFR-first’ strategies were adopted in the US and Japan.

In both cases, the requirement to switch quoting conventions proved to be a critical catalyst, leading to 69% growth in SOFR trading and 112% in TONA in August, the first full month after the strategies were implemented.

Of course, there is still a way to go, but the rise in RFR trading volumes is a positive sign that market participants recognize the need to switch to alternative reference rates for all new trades.

Progress has also been made in transitioning legacy positions ahead of year-end, but, again, there is further work to be done. In December, the major clearing houses will convert all existing cleared swaps linked to euro, sterling, Swiss franc and yen LIBOR to RFR overnight index swaps. This, at a stroke, will eliminate a large volume of legacy LIBOR exposures.

For non-cleared derivatives that continue to reference LIBOR at the start of 2022, we have the safety net of the ISDA IBOR Fallbacks Protocol. So far, more than 14,500 entities across 90 jurisdictions have adhered to the protocol, which incorporates robust fallbacks into existing non-cleared derivatives.

This means legacy LIBOR trades will automatically switch to an adjusted RFR following cessation or non-representativeness, dramatically reducing the systemic risk posed by LIBOR's demise.

The ISDA protocol remains open for adherence, and there's still time to sign up for those who haven't yet taken the plunge.

ISDA is now developing a second set of fallbacks for other IBORs in India, Malaysia, Norway and the Philippines. Two of those rates – in India and the Philippines – use US dollar LIBOR as an input, so its important robust fallbacks are in place before the remaining five US dollar LIBOR settings either cease to be published or are deemed non-representative in mid-2023. We're making good progress, and we plan to publish that new protocol by the end of this year.

All of this gives me cause for optimism that we are headed for a smooth transition away from LIBOR. Nonetheless, we must maintain the momentum as we move closer to the end-2021 deadline, ensuring RFR trading continues its upward trajectory, and the appropriate arrangements are in place for legacy positions.

Digital

I'd like to finish by touching briefly on our digital initiatives. During the course of this year, we have advanced further towards our ambition of a fully digital derivatives trade lifecycle. Publication of the 2021 ISDA Interest Rate Definitions in June marked a major milestone on that journey. This is ISDA's first natively digital definitional booklet, underpinned by MyLibrary, our brand-new digital documentation platform.

Market participants are now starting to adopt the 2021 Definitions, but this is only the beginning of the digital revolution. MyLibrary allows us to revise documents far more efficiently than in the past, removing the need for endless supplements, revisions, and paper trails. As we add more documents to the platform in the months and years ahead, we will pave the way towards greater automation and efficiency in the management of legal documents.

As I mentioned earlier, we are also exploring the fast-growing crypto-derivatives market. We very much intend to stay in our lane here, so our focus will be on the legal, documentation and capital issues associated with crypto assets.

As an example, we're currently looking at the issues that would need to be addressed before market-standard templates and definitions for crypto derivatives can be developed, including product scope, valuation and settlement and implications of adjustment and modification events. Expect to hear more about this before the end of the year.

As I noted at the start of these remarks, we are slowly emerging from the COVID crisis and facing up to the challenge of the climate crisis. It's a time of both hope and anxiety.

But ISDA is committed to helping the industry meet these challenges head on, by developing mutualized solutions, legal documents, and best practice standards, and by setting the foundations for a digital future. We very much hope you will join us on that journey.

I’d like to finish by thanking our sponsors, our speakers and our delegates for supporting these regional events. I’m looking forward to hearing the insights of our keynotes and panelists, and I hope you find the sessions engaging and constructive.

Thank you.