**George Handjinicolaou address**

**ISDA Annual General Meeting, Singapore, April 25, 2013**

Ladies and Gentlemen,

Good morning. I hope you all had a great evening last night at the reception at the Flower Dome sponsored by ISDA and Markit. Yesterday, we had quite a few interesting sessions and it is our hope that you will find today's sessions equally interesting, as they delve into many of the practical issues that we all face on a day to day basis.

The past 30 years have witnessed unprecedented growth in the financial services industry, and the OTC derivatives market has been at the forefront of this growth.

Deregulation, product innovation and the resulting market integration have been the driving forces that have brought about the the most global of markets, the OTC derivatives market.

Single national financial markets, previously isolated, were joined up by successive market innovations, such as currency swaps which brought together capital market activities around the world. Equally, products such as interest rate swaps and credit derivatives brought about a closer integration of money markets, capital markets and banking markets.

The resulting specialization and exchange of such products, skills and services boosted activity around the globe. The process was similar to that observed in the international trade context and best captured in classic economics by David Ricardo in the theory of comparative advantage.

It enabled participants around the world to focus on what they did best and reduce or eliminate other risks which were peripheral to their business – be they currency, commodity, interest rate, credit or other risks.

In fact, the OTC derivatives market has been, and continues to be perhaps the single most important example of a globally traded market, drawing participants from all corners of the world.

For example, the US dollar or Euro-denominated interest rate swap market draws interest worldwide. Japanese, Asian or European corporate fixed rate payers can be matched, for instance, by US based floating rate payers and vice-versa.

Eliminating unwanted risks, such as currency, interest rate and other similar risks, has made projects doable which otherwise would not be feasible. By doing so, it has boosted global business by enabling capital, trapped otherwise in certain regions in the world, to be invested elsewhere. Derivative products have been a major contributor to rapid global growth and prosperity.

Yet, this ecosystem is under threat. And the major driver of this threat is regulation.

*Or rather, the way regulation is being implemented in an inconsistent and contradictory manner*.

Today, I want to focus on the slowly emerging dangers of global market fragmentation, and the unintended consequences this development may have.

In the aftermath of the 2007-2008 crisis, the G20 policy makers, meeting at Pittsburgh in 2009, called for a series of global policy steps to improve systemic resiliency and transparency.

With respect to the OTC derivatives market, they called for steps to reduce counterparty risk through the clearing of standardized derivatives and increased capital and margin requirements against OTC derivatives exposures.

They also called for enhanced transparency through reporting of OTC derivatives activity and capturing it in repositories.

These were sensible objectives that were applauded and adopted by the OTC derivatives industry, which had already taken significant steps in this direction even before the crisis.

Clearing activities have been under way since 1999 at LCH, and the first repository for credit derivatives – the Trade Information Warehouse, was built by DTCC as early as 2007.

What has followed has been a series of local jurisdiction implementations, in the form of Dodd-Frank in the USA, EMIR in Europe, as well as other similar initiatives around the world.

However, it is the way the G20 objectives are being *implemented* that leaves room for concern for the global integration process.

Although these local initiatives have been driven by the same global objectives, their implementation is turning out to be inconsistent and overlapping, resulting in duplicative and at times contradictory application of these objectives.

And if this was not enough, additional regulatory initiatives are being undertaken regionally that, apart from being inconsistent across regions, are not related to the G20 objectives of reducing systemic risk and increasing transparency.

Thus far, the result has been increased uncertainty, increased complexity and increased costs for global market participants.

Allow me to cite a few specific examples of how inconsistent implementation has global market consequences:

1. *Extraterritorial regulatory reach is one*: For instance, Dodd-Frank employs the concept of registration and the definition of “US person” is fundamental to this process as it determines who is subject to US regulatory rules. As it currently reads, the definition extends to entities beyond the US, creating extra-territorial reach of Dodd-Frank.

   FTT, the proposed financial transaction tax in Europe, is another example of extra-territorial reach where the origin of the product is one of the criteria used for the application of the tax, potentially affecting users of such products around the world.

   Also, certification requirements by CFTC and ESMA, in particular of third country CCPs, is yet another example of extra-territorial reach that affects market participants operating in Asia, such as China, Korea and India and others.

2. *Reporting requirements give rise* more examples. The industry, recognizing the need for increased transparency, set out to create single-asset class global repositories. Yet, local jurisdictions are asking for the creation of local – and in many cases multiple – repositories. The upshot of this is, duplicate efforts around the world, with fragmented information sets containing partial sets of data. This, in turn, leads to multiple and duplicative reporting demands on market participants.

   Worse; the end result is the absence of a centralized place where policy makers can look for a complete information set about an asset market, defeating one of the most important purposes of the regulatory transparency requirement.

3. The list of inconsistent implementation extends to different margin requirements in the US, Europe and elsewhere. For example, in the US, clearing margins are based on a 1-day confidence interval for listed futures on OTC derivative products, 2-days in Europe, and 5-days for cleared and identical unlisted OTC derivative products.

Likewise, the ban on short-selling of sovereign CDS in Europe is already causing unintended consequences in other markets as participants shift their activities in search of suitable hedges.

4. Even when it comes to globally coordinated initiatives, such as the Basel III rules and the global proposals for margin for non-cleared OTC derivatives, there are signs of emerging local jurisdictional issues and inconsistencies.

   Uneven application of the proposed Basel III rules is leading to different local implementations, as they apply to OTC derivatives, such as the CVA treatment.

   Also, the proposed regulations – be they capital or other - may require that global banks, operating branches in various countries, may have to establish independently capitalized subsidiaries in the jurisdictions in which they operate.

   The proposed margining for non-cleared OTC derivatives also may be subject to similar effects. These could range from;

   - differences in collateral practices and availability of such collateral in many of the localities;

   - lack of enforceability in certain jurisdictions of netting provisions on which efficient margining is based; and

   - challenging collateral ownership issues in case of clearing member insolvency due to differences in the solvency regimes around the world.

   And all this, before we have begun to fully comprehend the risk management and exposure management issues associated with the fragmentation of the ISDA Master Agreement netting sets, as risk is split among many CCPs worldwide.

So.

*What will the effect of these inconsistencies be?*

For sure, they will lead to increased costs for all users of OTC derivatives.

Increased regulatory, compliance, and operational requirements, as well as new capital needs implied by the new regulations, imply higher costs for the providers of these products.

In addition, providers are faced with increased uncertainty as to the outlook for business, particularly as a lot of the regulations seem to be affecting existing market structure.

*And what does it mean for end users?*

It means either no availability of these products, or availability at much higher cost.

Market participants, including most sovereigns, which currently shop the capital markets around the world, borrow in the market with the lowest cost, and swap back to home currency, may not be in a position to do so in the future, as currency swaps may not be available at all, or only available at prohibitively expensive terms.

Similarly, participants may find that the cost of hedging their currency, interest rate, commodity or credit exposures costs is just too high, preferring to leave these risks either unhedged – taking unnecessary risks – or simply abandoning these projects. This can not be good news for global trade and the global economy.

With respect to costs and increased complexity, it remains to be seen whether international banks operating across several jurisdictions have the resources and the appetite for such increased requirements. Increased regulatory and capital requirements, combined with reduced business activity caused by uncertainty, do not bode well for global players.

The expectation is that only a few of them will continue to play such a role, with many others retreating back to their home countries, abandoning opportunities to finance and service their clients' overseas activities. Again, this cannot be good news for global trade.

The global financial sector is the backbone of the world's economic activity. It is evident from the few examples that I have listed, that regulatory reform will impact international financing activities, fragmenting financial flows, directly impacting the ability of market participants to function properly and support their international trade activities.

And this poses interesting questions that should concern global policy makers.

All these global regulatory initiatives, one way or another, reduce systemic risk, *but at what cost to the global economy*?

Are the benefits derived from such systemic risk reduction commensurate to the costs that are likely to be imposed on the real economy? Particularly at a time when economic growth is what everyone is looking for?

**We urge global policy makers to globally coordinate all these regulatory initiatives.**

**We also urge global policy makers to look into the cost-benefit considerations of the cumulative effects of these overlapping and contradictory regulatory**

**measures, as we see increasing signs of the negative unintended consequences outweighing the potential benefits.**

In this respect, it is comforting to hear that the BIS will be undertaking a study of the macroeconomic effects of regulatory reform.

Now.

Before I leave you all depressed with my observations, I would note that there is a silver lining in the rather gloomy picture that I have painted. And this has to do with the local markets.

To the extent that the above observations are likely to materialize, local markets, such as here in Singapore as well as other Asian and generally local markets at large, are likely to be beneficiaries of further market fragmentation.

Such markets are likely to benefit from the local creation of savings, and it is more likely that they will create their own channels for reaching out to local investors.

This will lead to the further development of the local markets, possibly at the expense of global centers where flows have been channelled traditionally.

Which makes this a good moment to segue to our next presentation on the Asian derivatives market, using the study published yesterday by Celent as a focal point.  With this, I am passing the mike to Bob Pickel, ISDA's CEO.  Thank you.