ISDA Annual General Meeting
May 11, 2021

Opening Remarks
Scott O'Malia, Chief Executive Officer, ISDA

Hello everyone, and welcome back to ISDA's 35th Annual General Meeting.

It's day two of our flagship event and it's been great to connect with delegates all over the world, albeit in a virtual setting. Our last AGM took place in Hong Kong in 2019, and I never would have imagined that the next one would be fully virtual. I've really missed travelling to Asia to meet with members and regulators, and I very much look forward to doing so again soon when travel restrictions ease.

We're going to start the day with two Asia-focused panels – one looking at the approach to benchmark reform in Japan, and the other exploring developments in China's derivatives market. Asia represents a substantial and important part of ISDA's membership, and we've always been committed to supporting the development of safe and efficient derivatives markets across the region.

Now more than ever, we recognize the enormous growth potential in Asia, and are working closely with market participants in some very important areas. I'd like to start by highlighting three recent developments that demonstrate the focus we're placing on this region.

First, in September 2020, India's financial markets took a huge step forward with the passage of legislation on the enforceability of close-out netting. ISDA worked closely with the Indian authorities for several years to make this happen. As with so many other jurisdictions, netting certainty in India will set the foundations for a strong, safe and efficient derivatives market.

Second, as firms prepare for the implementation of phases five and six of the initial margin (IM) requirements for non-cleared derivatives, market participants need to decide what assets to post as IM and understand any regulatory or legal impediments associated with them. Together with the China Central Depository & Clearing Corp (CCDC), ISDA has published a whitepaper that analyzes issues relating to the use of Chinese government bonds as collateral.

And finally, as we continue to work closely with Chinese authorities to move towards the recognition of close-out netting, we are also developing a whitepaper that will explore the important next steps for China's derivatives markets once netting has been achieved.

In my remarks today, I will explore three key areas for derivatives markets in Asia-Pacific – benchmarks, close-out netting and initial margin.

Benchmarks

Turning first to benchmark reform.

As we discussed yesterday, we now have a clear timetable for the death of LIBOR following the UK Financial Conduct Authority's announcement on March 5. We know that 30 LIBOR settings will either cease or become non-representative at the end of this year, while five of the most popular US dollar LIBOR settings will continue until mid-2023.

It's important to note that the extra 18 months for US dollar LIBOR should not be seen as a delay. In fact, some regulators, including the US Federal Reserve, have said they expect to use supervisory powers to restrict new use of US dollar LIBOR from the end of 2021.

That means firms really should be working towards using alternative reference rates no later than by the end of this year. As big users of LIBOR, and US dollar LIBOR in particular, institutions in Asia cannot afford to take their foot off the pedal.

Alternative rates are available and liquidity in products referencing those rates is increasing. According to analysis by ISDA and Clarus, 8.8% of total cleared OTC and exchange-traded interest rate derivatives DV01 was linked to risk-free rates (RFRs) in March, up from 5.3% in March 2020.

But there's clearly still a lot of work to do. Just 4.7% of US dollar interest rate derivatives DV01 was referenced to SOFR in March. When it comes to Australian dollar and Japanese yen, only 5.1% and 2.4% of total cleared interest rate derivatives DV01 in those currencies was referenced to RFRs.

Ultimately, we expect liquidity in RFRs will steadily increase as we approach the end-2021 deadline. Transition milestones set by the official sector and various RFR working groups will also likely help. For example, the Cross-industry Committee on Japanese Yen Interest Rate Benchmarks has recommended that new swaps linked to yen LIBOR with a maturity after the end of 2021 should stop by September 30.

Of course, risk-free rates aren't the only options out there. Many jurisdictions in Asia, including Australia, Hong Kong and Japan, have opted for a multi-rate approach, with local IBORs co-existing with local currency RFRs. In some countries, like Japan, a forward-looking RFR term rate is also available.

I'm looking forward to hearing more about the transition effort in Japan in our first panel today.

From our perspective, an important part of the transition is the adoption of robust fallbacks. So far, more than 13,800 firms globally, including more than 1,200 from Asia-Pacific, have adhered to an ISDA protocol that allows firms to incorporate the fallbacks into existing derivatives linked to LIBOR and other key IBORs. The protocol is still open for adherence, so I encourage all of you who haven't yet adhered to look closely at that.

Netting

Now, no overview of Asia-Pacific would be complete without recognizing the enormous growth of China.

In recent years, China has taken major steps to liberalize its financial markets and remove barriers to international participation. As firms all over the world access China's markets, it is more important than ever that institutions can effectively manage their risk.

A safe and well-functioning derivatives market is critical in allowing banks to hedge the risks they take. In turn, this means they can increase lending and support for the real economy, boosting the development of vibrant capital markets. Firms are willing to do business with a wider range of counterparties if they know they can hedge the risk of trading with them, encouraging greater liquidity.

But let me be very clear. A functioning derivatives market requires a robust and predictable legal framework, which must include enforceability of close-out netting. By allowing parties to combine their obligations into a single payment, netting mitigates the credit risk associated with derivatives and means a default is less likely to be disruptive to the financial system. It also encourages more active participation by both foreign and domestic firms, supporting liquid and efficient capital markets.

Important progress has been made in China in recent years. ISDA will continue to work closely with Chinese agencies on the draft Futures Law to further advance progress on this critical issue.

Enforceability of close-out netting in China continues to be one of ISDA's biggest priorities in the region. But we must also think about next steps. What needs to happen when netting is enforceable in China? What further developments will be needed to promote a mature and effective derivatives market?

As I mentioned earlier, ISDA is developing a whitepaper that will explore this very issue. The paper sets out how an efficient and vibrant derivatives market will contribute to China's financial system and ultimately support economic growth. It also recommends a series of policy measures and actions to support a robust, safe and efficient derivatives market. These include government and regulatory policies, trading practices, risk management procedures and risk governance, and market infrastructure.

We will be sharing these recommendations with policy-makers and market participants in the weeks ahead as we continue to support the development of a liquid and well-functioning derivatives market in China.

Margin

Before I finish, I'd like to say a few words about margining requirements for non-cleared derivatives.

We are now just a few months away from the deadline for phase-five entities to begin posting IM in September 2021. Together with phase six in September 2022, we expect a large number of firms in Asia-Pacific to come into scope. As well as putting new documentation, systems and processes in place, in-scope entities will need to think carefully about the collateral they intend to post and understand the regulatory and legal impediments that may affect their choice.

Given the rapid growth of China's bond market and its opening up to overseas investors, more and more firms are keen to explore the use of Chinese government bonds as IM. In response, ISDA has collaborated with the CCDC to consider the various legal, regulatory and market structure issues associated with this, and we recently published a joint whitepaper in both Chinese and English.

ISDA has always been committed to an effective global framework for the margining of non-cleared derivatives, and has built the tools for market participants to achieve this. Those tools include industry documentation, the ISDA Standard Initial Margin Model and ISDA Create for the online negotiation and execution of margin agreements. I hope this paper will also serve as a valuable tool for the many firms in Asia-Pacific now preparing to implement IM requirements.

Conclusion

I've talked about the various steps ISDA is taking to support the continued development of safe and efficient derivatives markets in Asia-Pacific. While we continue to operate in the midst of a pandemic, the challenging circumstances have not slowed our progress in working towards forthcoming deadlines and addressing market structure issues. You can count on ISDA to continue to work hard on these initiatives in the months ahead.

With the rollout of vaccines around the world, I very much hope that better times lie ahead, and we will be able to meet in person again soon. In the meantime, I would like to thank our sponsors and speakers, and hope you find today's sessions engaging and constructive.

Thank you.