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IQ

ISDA® Quarterly

Vol 10, Issue 1: March 2024 | www.isda.org

*NEW BLOSSOM

The reversal of negative interest rates in Japan is expected to drive more active trading and investment, with increased demand for derivatives and risk management

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ISDA SwapsInfo brings greater transparency to the over-the-counter (OTC) derivatives markets. It transforms publicly available data on OTC derivatives trading volumes and exposures into information that is easy to chart, analyze and download. ISDA SwapsInfo covers interest rate derivatives (IRD) and credit derivatives markets.

Interest Rate Derivatives

Transaction Data

Daily, weekly and quarterly traded notional and trade count by product taxonomy.

Notional Outstanding

Notional of all IRD contracts outstanding on the reporting date.

Credit Derivatives

Transaction Data

Daily, weekly and quarterly traded notional and trade count by product taxonomy.

Market Risk Activity

Traded notional and trade count for single-name and index credit default swaps (CDS) that result in a change in market risk position.

Notional Outstanding

Gross and net notional outstanding and trade count for single-name and index CDS.

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ISDA® Safe, Efficient Markets

Back to Asia

Our Annual General Meeting (AGM) in Tokyo on April 16-18 will be the first time ISDA has held this event in Asia Pacific since 2019. Back then, topics on the agenda included benchmark reform, margin requirements for non-cleared derivatives and the impact of regulatory fragmentation. It would be something of an understatement to say a lot has happened since then – the pandemic, Russia's invasion of Ukraine, the UK gilt crisis and instability in the Middle East. It means geopolitical risk has trumped all else and rocketed to the top of the risk management agenda.

This year's AGM reflects that change. We'll explore how geopolitical risks have shaped market dynamics and how firms are navigating the current environment. We'll look at how these events have disrupted the functioning of markets, the lessons learned and the steps that have been taken to plug gaps. We'll also examine the measures regulators are pursuing to enhance market resilience as a result, including a US Securities and Exchange Commission requirement for certain US Treasury securities to be cleared, a global review of margin practices and procyclicality and increased scrutiny of the non-bank financial intermediation sector.

In this issue, we preview the AGM and hear from senior regulators and market participants on the key issues that will be covered at the event. We also look at developments in the host country, Japan – specifically, how the recent reversal of the Bank of Japan's negative interest rate and yield curve control policies might affect the country's derivatives markets.

The AGM is a great opportunity to get a snapshot of the key issues in derivatives markets, hear from the leading lights in the industry and get up to speed with best practices and market intelligence. And, of course, to network with colleagues old and new. We very much hope to see you there. If you haven't already, there's still time to register at agm.isda.org.

Nick Sawyer
Global Head of Communications & Strategy
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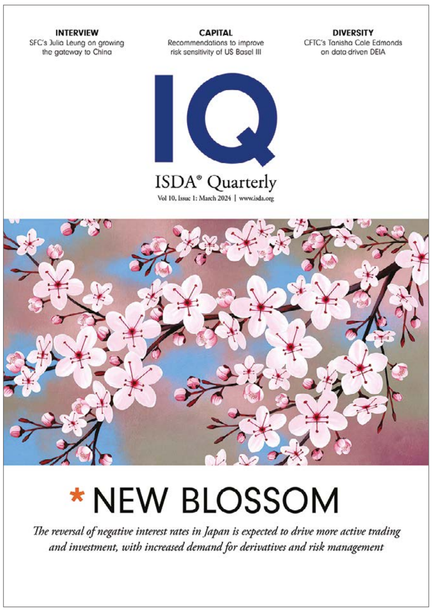

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"The FSA will work on reforming the asset management sector and asset ownership in Japan. This is not a one-shot initiative, and it will be important to steadily implement measures in the medium to long term. The FSA hopes this will lead to economic transformation"

Shigeru Ariizumi, Financial Services Agency

Learning from Disruption

Recent disruption events are informing the review of the FX definitions and the development of the ISDA Notices Hub, writes ***Scott O'Malia***

Disruption has been a recurring theme of the past four years. From the outbreak of the pandemic to Russia's invasion of Ukraine and the subsequent sanctions on Russian entities, external shocks have had far-reaching implications for financial markets, the economy, businesses and individuals. These episodes have informed two key initiatives we're prioritising this year: the review of the 1998 FX and Currency Option Definitions and the development of the ISDA Notices Hub.

FX is the world's largest financial market, with a daily turnover of $7.5 trillion, according to the last triennial survey by the Bank for International Settlements. This requires a robust legal framework that is tailored to the modern world, with all its challenges and uncertainties. The 1998 definitions have done a good job, but after 25 years, it's time to review and update them.

This was reinforced by the Russian invasion, which required ISDA and EMTA to develop a bilateral amendment agreement to allow parties to switch to non-deliverable settlement if it became impossible to deliver or convert rubles. That's exactly the kind of disruption event the review of the definitions will address.

"From the outbreak of the pandemic to Russia's invasion of Ukraine, external shocks have had far-reaching implications"

We're now pushing ahead with the review, working together with our members and other entities including EMTA, SWIFT and the Global FX Division of the Global Financial Markets Association. We'll tackle the substantive issues this year and complete the drafting in 2025, so now is the time to get involved.

The development of the ISDA Notices Hub addresses another issue that has been a recurrent theme of recent disruption events – the arcane and costly process of closing out derivatives trades. As it stands, termination notices must be physically delivered to a counterparty's office, using the address details listed in the ISDA Master Agreement. Problems have arisen when a counterparty moves to a new office but the documentation is not updated with the new address, or when it suddenly becomes difficult to deliver or receive notices – as it did during the pandemic and after Russia's invasion.

Delays in the delivery and receipt of notices can have serious economic consequences, creating uncertainty over the time at which trades can be valued prior to close out. ISDA analysis has shown that even a short delay in the delivery of a termination notice can result in losses running to millions of dollars. That's on top of the resource costs associated with physical delivery, which would usually include paying a law firm to deliver the notice.

It's time to bring the delivery of notices into the digital age. The ISDA Notices Hub would enable the instantaneous delivery and receipt of notices from anywhere in the world via an online platform.

We've tested market demand and received positive feedback on this facility. We're now seeking commitments of support from dealers and large buy-side firms before we move to the development phase. Like the review of the FX definitions, the success of this project hinges on industry support, so I urge everyone to get onboard and help us to bring it to fruition.

Preparing for future disruption is also a priority for policymakers. The wide-ranging package of regulations implemented since the global financial crisis has made markets and firms far more resilient to stress events. But this work is not yet finished. The final parts of the Basel III framework will be implemented in the coming years, alongside increased clearing of certain US Treasury securities and repo transactions.

Unfortunately, the US Basel III proposals as drafted would make it more difficult for banks to offer critical risk management and intermediary services to their clients. Nowhere is this more evident than central clearing. ISDA undertook quantitative impact studies with input from US global systemically important banks (G-SIBs) and found the combined effect of the Basel III and G-SIB capital surcharge proposals would lead to an 80% increase in capital requirements for client clearing businesses.

To impose such a burdensome tax on the low-margin clearing business would be inconsistent with the broader policy objective of promoting and incentivising clearing. We continue to engage with US policymakers on this important issue.

The management of disruption will be one of the agenda items at ISDA's 38th Annual General Meeting in Tokyo on April 16-18. It's always a fascinating event, so make sure you book your delegate pass at agm.isda.org. I look forward to seeing you in Tokyo.

Scott O'Malia
ISDA Chief Executive Officer

US Agencies Urged to Review Supplementary Leverage Ratio

ISDA has written to the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency to urge them to reintroduce a permanent exclusion of US Treasury securities from the supplementary leverage ratio (SLR) calculation. This will provide greater capacity for banks to expand their balance sheets and provide liquidity, enhancing the resilience of the Treasury market, ISDA says.

A temporary exclusion of US Treasury securities from the SLR calculation was introduced as an emergency measure in April 2020 to ease strains in the Treasury market due to the pandemic. ISDA believes a permanent exclusion would better promote the stability and resilience of the Treasury market and give banks more certainty to expand balance sheet capacity than a temporary exclusion introduced during a period of market stress.

"To facilitate participation by banks in US Treasury markets – including clearing US Treasury security transactions for clients – the agencies should revise the SLR to permanently exclude on-balance-sheet US Treasuries from total leverage exposure, consistent with the scope of the temporary exclusion for US Treasuries that the agencies implemented in 2020," ISDA wrote on March 5.

A series of market stresses, including the dash for cash in March 2020, has exposed the susceptibility of the US Treasury market to liquidity shocks, prompting regulators to look for ways to enhance the resilience of the market. For example, the Securities and Exchange Commission finalised rules in December 2023 that will require certain cash Treasury securities and repo transactions to be centrally cleared.

However, the SLR acts as a non-risk-sensitive binding constraint on banks and can impede their ability to act as intermediaries, including their capacity to clear for clients. This is particularly relevant during times of stress, which is what prompted the Federal Reserve to take emergency measures in 2020 to improve liquidity in the Treasury market.

Other prudential regulatory proposals in the US, including Basel III and the capital surcharge for global systemically important banks (G-SIBs), could further constrain balance sheets and force banks to reduce their intermediation activities. An industry quantitative impact study has shown their combined effect would increase capital for clearing businesses by more than 80%.

> "We think regulators should think hard about the impact of various rules in combination to ensure they achieve the policy outcomes they want"
> **Scott O'Malia, ISDA**

"We think regulators should think hard about the impact of various rules in combination to ensure they achieve the policy outcomes they want. In this context, a permanent exclusion of US Treasury securities from total leverage exposure would free capacity for banks to participate in US Treasury markets and facilitate access to cleared markets, especially during periods of stress," says Scott O'Malia, chief executive of ISDA.

The letter to US agencies recommends the permanent exclusion should cover on-balance-sheet US Treasuries that banks hold in inventory or as part of their liquidity portfolios, as well as those received in repo-style transactions that are recorded on balance sheet. In addition, ISDA proposes that the size systemic indicator within the G-SIB surcharge should be revised to exclude on-balance-sheet US Treasuries.

"This is particularly important given the wave of new issuance expected in the coming years. US Treasury market outstanding issuance is at a record high of more than $26 trillion and is forecast to rise to $48 trillion by 2034, raising questions about how this supply will be absorbed. Given the vital role banks play in supporting liquidity and providing access to client clearing, a permanent exclusion will contribute to a safer, more efficient and more resilient US Treasury market," says O'Malia.

ISDA has also provided feedback on the US Basel III proposal, submitting a joint response with the Securities Industry and Financial Markets Association on January 16. A quantitative impact study with input from eight G-SIBs showed market risk capital would increase by between 73% and 112%, depending on the extent to which banks use internal models.

ISDA has proposed a series of calibration changes to make the rules more appropriate and risk sensitive and avoid a negative impact on the liquidity and vibrancy of US capital markets. IQ

For more on the US Basel III proposals, see pages 36-39

Independent Review of Determinations Committee Process Gets Underway

ISDA has launched a review of the structure and governance of the Credit Derivatives Determinations Committees (DCs) and appointed Linklaters to conduct an independent assessment and recommend any changes to maintain the integrity of the DCs in changing economic and market conditions.

The purpose of the independent assessment is to identify current market views on potential changes that could be made to improve the governance and structure of the DCs. Once complete, a report will be published on ISDA's website and opened to a market-wide consultation to determine which of the potential changes, if any, have broad support from market participants and other stakeholders. ISDA will then work with members to develop specific implementing changes that will be recommended to the DCs for action.

As part of the process for developing the report, Linklaters has been conducting a series of interviews with market participants and other stakeholders, including regulators and academics, to determine what steps might be taken to improve the functioning of the DCs.

"The DCs have now been in operation for nearly 15 years with the same fundamental structure put in place in 2009, but the number of firms willing to serve on the DCs has declined steadily in recent years. While there is no minimum number of DC members, and the DCs function effectively and can continue to do so, we think now is the appropriate time to consider whether potential changes could be made to maintain a robust, centralised and transparent mechanism for the determination and settlement of credit events, which is vital for the central clearing of credit default swaps (CDS). ISDA does not have any specific changes in mind, and we will wait for the results of the review by Linklaters for potential ideas," says Scott O'Malia, chief executive of ISDA.

> "We think now is the appropriate time to consider whether potential changes could be made to maintain a robust, centralised and transparent mechanism for the determination and settlement of credit events"
>
> **Scott O'Malia, ISDA**

The DCs, which comprise up to 10 sell-side and five buy-side voting firms, ensure there is a single decision-making process for determining whether a credit event has occurred, avoiding the potential for uncertainty, disputes and conflicting outcomes across different sets of CDS counterparties. Having certainty that all contracts would have the same outcome meant CDS could be cleared at central counterparties, a regulatory priority after the global financial crisis.

However, the market for credit derivatives has changed significantly since the DCs were introduced in 2009, with new regulations, capital requirements and market structures. The number of firms willing to participate on the DCs has fallen from 26 in 2009 to 12 today.

On January 26, the DCs announced that they are considering whether certain changes should be made to the DC rules. This initiative is separate from ISDA's independent review of the DCs. IQ

Indicative Support for ISDA Notices Hub Sought from Industry

ISDA is seeking indications of support from dealers and large buy-side firms before moving forward with the development of the ISDA Notices Hub, which would enable the instantaneous electronic delivery and receipt of critical termination notices from anywhere in the world via a central platform.

The delivery of notices is an important part of the close-out process following a default or termination event under a derivatives contract. The ISDA Master Agreement stipulates that notices must be delivered by certain defined methods, using the company address details listed in the agreement. However, delays and uncertainty over the delivery and receipt of notices are common and can have knock-on implications.

ISDA has worked with administrators of the London-based broker-dealer of Lehman Brothers from PwC to analyse a random sample of 255 terminated derivatives relationships. The results suggest around 16% of termination notices were delivered to an office the bank had vacated four years prior to its bankruptcy.

"Uncertainty over the effectiveness and timing of the delivery of notices can have significant economic and legal consequences. For an entity serving a notice, this type of scenario can raise questions over whether the delivered notice is effective and, if so, when," says Katherine Tew Darras, ISDA's general counsel.

ISDA has developed a specification for the Notices Hub and once sufficient indications of support have been obtained from market participants, the development phase will begin. IQ

For more information about the ISDA Notices Hub, visit: www.isda.org/isda-notices-hub

ISDA Explores Future of India's Derivatives Market

ISDA has published a whitepaper that explores the growth of India's financial markets and makes a series of market and policy recommendations to encourage the further development of a safe and efficient over-the-counter (OTC) derivatives market.

India's economy is expected to grow significantly in the coming years and is forecast to become the world's third largest by 2030. Despite this, the country's OTC derivatives market remains small, with average daily turnover of interest rate derivatives reported by sales desks in India accounting for just 0.1% of the global market in 2022, according to the Bank for International Settlements.

While Indian authorities have taken important steps to develop the country's derivatives market – notably, by passing legislation to ensure the enforceability of close-out netting in 2020 – the whitepaper proposes several initiatives that industry participants and regulators could take to create deeper and more liquid domestic derivatives markets and enhance risk management practices.

"We think there's a significant opportunity here. Derivatives are critical for healthy, competitive financial markets and help spur economic growth. They give companies the ability to raise financing at the best rate and manage their risks, enabling those firms to invest and grow," said ISDA chief executive Scott O'Malia, speaking at the ISDA India Derivatives Markets Forum in Mumbai on March 5.

Since 2020, Indian authorities have introduced several additional measures to support the development of India's derivatives market. These include increased access to onshore markets for non-residents, approval for Indian entities to post foreign currency collateral when trading with non-residents, and the introduction of a principles-based regulatory framework.

"All of these measures are extremely helpful. But we believe additional changes could further unlock the growth potential, creating deeper and more liquid financial markets," said O'Malia.

The recommendations in the ISDA paper are centred on five key pillars: broadening product development, innovation and diversification; fostering adoption of similar market and risk principles across regulatory regimes; enhancing market access and diversification of participants; ensuring growth in a safe and efficient manner; and encouraging greater alignment with international principles and practices.

For example, the paper recommends that market participants and benchmark administrators work to extend the duration of the benchmark curve to facilitate longer-term hedges, as well as develop standardised term benchmarks to reduce basis risk. It also proposes expanding the scope of the credit derivatives market beyond the current limited universe of bonds, debentures and money market instruments, and enabling onshore OTC commodity and equity derivatives markets.

Similarly, the paper calls for measures to increase the diversity of market participants, which could be achieved by regulators and industry participants working together to develop skills and expertise across the market through targeted education and awareness initiatives.

"We think participants should have access to a wide range of derivatives instruments to hedge their various risks fully and effectively, which is particularly important as the economy continues to grow and the diversity of participants increases," said O'Malia.

As well as having an expanded universe of products and participants, the paper recommends they are subject to a similar regulatory framework. In particular, the rules relating to the use of OTC interest rate and credit derivatives should be harmonised.

"Having a patchwork of regulators and rules for similar products increases complexity and places unnecessary operational burdens on market participants," said O'Malia. IQ

Read the paper, *Charting the Next Phase of India's OTC Derivatives Market*: tinyurl.com/4byv4jz3

ISDA Appoints Head of Solutions Adoption

ISDA has appointed Ankit Jain as head of solutions adoptions, a new role that will spearhead ISDA's drive to encourage broad adoption of its suite of mutualised industry solutions.

"We're very pleased to welcome Ankit to ISDA. His appointment is part of a broader strategy to ensure our various products and services are fully aligned and we maximise the potential for broad adoption. Ultimately, the greater the take-up of our mutualised solutions across the industry, the better the efficiencies and cost reductions for everyone, so there will be a big focus on raising awareness, explaining the benefits and encouraging implementation," says Scott O'Malia, chief executive of ISDA.

Jain joins ISDA from SoftServ, a software development and digital services company, where he was head of banking and trading domain solutions and transformation, responsible for managing front-office, trading, derivatives and technology transformation across banking and broader financial services clients. Before that, he led the change and oversight of large strategic transformation initiatives at Deutsche Bank from 2015 to 2022, having previously held various change leadership positions across multiple financial services companies. He started his career at Goldman Sachs in 1997.

"ISDA's story is woven into the fabric of the global finance and derivatives industries. Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient to facilitate effective risk management for all users of derivatives. With the development of a suite of digital products and solutions, ISDA is once again proving to be the go-to organisation for shaping the future of the derivatives industry. I am excited to lead ISDA's products and solutions implementation drive to broaden adoption across the industry," says Jain. IQ

Find out more about ISDA's solutions: www.isda.org/isda-solutions-infohub

Digital Equity Derivatives Definitions Launched

ISDA has launched a fully digital edition of the 2002 ISDA Equity Derivatives Definitions on the ISDA MyLibrary platform, enabling new versions to be released more efficiently as products and market practices evolve.

Following consultation with buy- and sell-side market participants, ISDA identified support to move the definitions to a digital format, develop new product provisions and streamline certain components over time. Publication of the 2002 ISDA Equity Derivatives Definitions (Versionable Edition) in digital form is a first step and enables further changes to be made in future versions.

Since the original publication of the 2002 ISDA Equity Derivatives Definitions, ISDA has published additional provisions via the 2011 ISDA Equity Derivatives Definitions, more than 50 equity derivatives master confirmation agreements, supplements and other model language templates, which counterparties can use in their documentation. The digital format will allow the definitions to be amended and restated in their entirety every time an update is needed, reducing the need for bilateral amendments.

"Bringing the 2002 ISDA Equity Derivatives Definitions onto MyLibrary represents a big step forward for this asset class, enabling participants to access the tremendous benefits of digital documentation. As part of ISDA's digital transformation strategy, we are committed to improving efficiency by digitising critical processes across the derivatives lifecycle. As we have seen since the launch of MyLibrary and the 2021 ISDA Interest Rate Derivatives Definitions, documentation is an area that is ripe for digitisation," says Scott O'Malia, chief executive of ISDA.

In its consultation with market participants, ISDA identified demand for new templates for products for which there is no standard documentation and standard provisions for methodologies that are not currently part of the ISDA equity documentation framework. There was also interest in streamlining multiple versions of the same terms across the existing equity documentation library and easing implementation of new provisions and templates. Now the definitions are available on MyLibrary, ISDA will work with members to develop a roadmap for digitising further provisions from other equity publications, as well as addressing areas of member interest.

> "Moving this flagship document to a digital format will yield unquestionable benefits. As products and market practices continue to evolve, MyLibrary allows updates to be made much more efficiently"
>
> **Eric Litvack, ISDA**

"The 2002 ISDA Equity Derivatives Definitions and subsequent ISDA equity publications have provided a robust foundation for this market for more than 20 years, and moving this flagship document to a digital format will yield unquestionable benefits. As products and market practices continue to evolve, MyLibrary allows updates to be made much more efficiently, without having to go through the cumbersome process of bilaterally amending existing documentation to incorporate new terms," says Eric Litvack, chairman of ISDA and chair of the ISDA Equity Steering Committee. IQ

ISDA Publishes Sustainability-linked Derivatives Clause Library

ISDA has launched a clause library for sustainability-linked derivatives (SLDs), designed to provide standardised drafting options for market participants to use when negotiating SLD transactions with counterparties.

SLDs embed a sustainability-linked cashflow in a derivatives structure and use key performance indicators (KPIs) to monitor compliance with environmental, social and governance (ESG) targets, incentivising parties to meet their sustainability objectives. While the market is still in its infancy and is highly bespoke, a survey conducted by ISDA in 2022 showed there is demand for ststandardised terms and clauses in specific areas to support the development of this product.

The ISDA SLD Clause Library provides standard-form drafting options in several key areas, including provisions stipulating what evidence of sustainability performance must be delivered and when, mechanisms to adjust cashflows depending on whether relevant ESG targets have been met, and options available to counterparties following disruption and review events.

"By their nature, SLDs are highly bespoke transactions, but the language that describes the terms and the objectives doesn't have to be. The ISDA SLD Clause Library is designed to eliminate unnecessary differences and bring greater standardisation to this market. This will bring more efficiency to the negotiation process and reduce risks, setting the foundations for this market to develop further," says Scott O'Malia, chief executive of ISDA.

Prior to the SLD Clause Library, ISDA had developed a variety of resources relating to SLDs, including a paper that described the details of the early transactions, a set of proposed guidelines for drafting KPIs and an analysis of the key regulatory issues. Following the 2022 survey, ISDA began drafting standard terms to improve efficiency while also retaining the necessary flexibility to allow SLDs to be tailored to meet firms' sustainability objectives.

The ISDA SLD Clause Library is available via the ISDA MyLibrary platform, allowing users to read and navigate the various provisions in a digital format. IQ

Frequently asked questions on the ISDA SLD Clause Library are available here: shorturl.at/bFJY8

THE COVER PACKAGE

New Blossom

The reversal of negative interest rates in Japan is expected to drive more active trading and investment, with increased demand for derivatives and risk management

Graphs and charts nearly always have a story to tell and those included in this edition of **IQ**, drawn from the Bank for International Settlements' triennial turnover survey, are no exception.

Since 2010, average daily turnover in Asia Pacific's foreign exchange (FX) and interest rate derivatives markets has increased steadily, reaching $1.9 trillion and $685 billion, respectively, in 2022. Yet Japan's share of those markets has dropped over the same period, falling from 27% to 15% for FX derivatives and from 44% to 7% for interest rate derivatives. It seems surprising that a country with an advanced economy and a sophisticated financial market, which once led the region in FX and interest rate derivatives, should have fallen behind other centres like Hong Kong and Singapore.

Multiple factors may lie behind this trend, but an extended period of unconventional monetary policy has certainly played its part. Between 2016 and 2024, the Bank of Japan (BoJ) maintained negative interest rates and control of the yield curve. Both policies came to an end on March 19 following the BoJ's latest monetary policy meeting, which could pave the way for more active trading and investment to resume, likely driving an increase in derivatives market turnover (see pages 12-15).

For market participants, the BoJ policy shift brings both opportunities and challenges. A reversal of the yen's depreciation and increased demand for Japanese government bonds will create a more normal market environment, with greater need for hedging and risk management. But after such a long period of abnormal market conditions, there is now a scarcity of practitioners with experience of normality (see pages 22-25).

Meanwhile, several regulatory changes are due to be implemented this year, including the final parts of the Basel III framework and changes to derivatives reporting rules. In an interview with **IQ**, Shigeru Ariizumi, vice minister for international affairs at Japan's Financial Services Agency and vice-chair of the International Organization of Securities Commissions, sets out the domestic and global regulatory priorities (see pages 16-20).

Amid these landmark policy changes and regulatory deadlines, ISDA's 38th Annual General Meeting takes place in Tokyo on April 16-18, with an agenda that will cover the key issues affecting both Japanese and global derivatives markets (see pages 26-29). IQ

"As the BoJ's monetary policy normalises, the use of derivatives for risk management and improved investment returns will be globally recognised and more active trading is expected to resume"

Yoji Imafuku, Mizuho Securities

Poised for Growth

During an eight-year period of negative interest rates and yield curve control, Japan's share of global derivatives market turnover declined, but the BoJ's decision to reverse those policies could drive a resumption of more active trading

Japan's 'lost decade' – a period of deep recession in the 1990s, when economic growth lagged well behind other industrialised nations – has become entrenched in the country's recent history as an example of the kind of trajectory policymakers would generally want to avoid. In 2024, Japan's derivatives market could be poised to emerge from a similar period of stunted growth, now that the Bank of Japan's (BoJ) long-running monetary easing policies have finally been brought to an end, unleashing expectations of more active trading and investment.

Despite being the world's fourth largest economy and home to a bustling financial market, Japan has seen its derivatives market falter in recent years, with a declining share of global turnover in foreign exchange (FX) and interest rate derivatives, according to data from the Bank for International Settlements (BIS). But following the end of an eight-year period of negative interest rates and yield curve control (YCC) policies, it is anticipated that trading in Japan's fixed income and derivatives markets could now pick up.

3%

Fall in average daily turnover of OTC FX and interest rate derivatives in Japan between 2016 and 2022

"Market participants have operated in an abnormal environment for the past eight years, with the BoJ having full control over interest rates and government bond yields. A return to more conventional monetary policy is expected to bring new opportunities and increase the attractiveness of Japanese government bonds (JGBs) and derivatives. In turn, this should drive an increase in Japan's share of global trading in FX and interest rate derivatives," says Tomoko Morita, senior director and head of the Tokyo office at ISDA.

Abnormal times

Japan's negative interest rate policy dates back to January 2016, when its benchmark rate was cut from 0.1% to -0.1%

Illustration: James Fryer

in a bid to reach the BoJ's 2% inflation target. Just eight months later, in September 2016, the BoJ unveiled its YCC policy, in which longer-dated bond yields would be kept at or close to zero to encourage greater spending and investment.

Both policies remained in place for eight years but were finally reversed on March 19, following a widely anticipated announcement after the BoJ's latest monetary policy meeting. While this lengthy period of loose monetary policy may have been necessary to boost the economy and reverse deflation, there is no doubt it has affected the country's financial markets, dampening appetite for JGBs and driving depreciation in the yen.

"Unconventional monetary policies have reduced liquidity in Japanese money markets and JGBs. As money market rates turned negative, investment shifted to bank deposits and banks needed to invest those increasing deposits. However, with the BoJ buying a huge volume of JGBs at the same time, initially to expand its monetary base and later as part of YCC, bond yields fell too. The combination of negative interest rates and YCC has led to a sharp decline in investment returns, while the retention of negative interest rates as other central banks started to hike rates has caused a sharp depreciation of the yen," says Naomi Muguruma, chief fixed income strategist at Mitsubishi UFJ Morgan Stanley Securities.

The sustained weakening of the yen has been an unmistakable trend in recent years, with other major currencies gaining ground as interest rates in those countries have risen while the BoJ maintained negative rates.

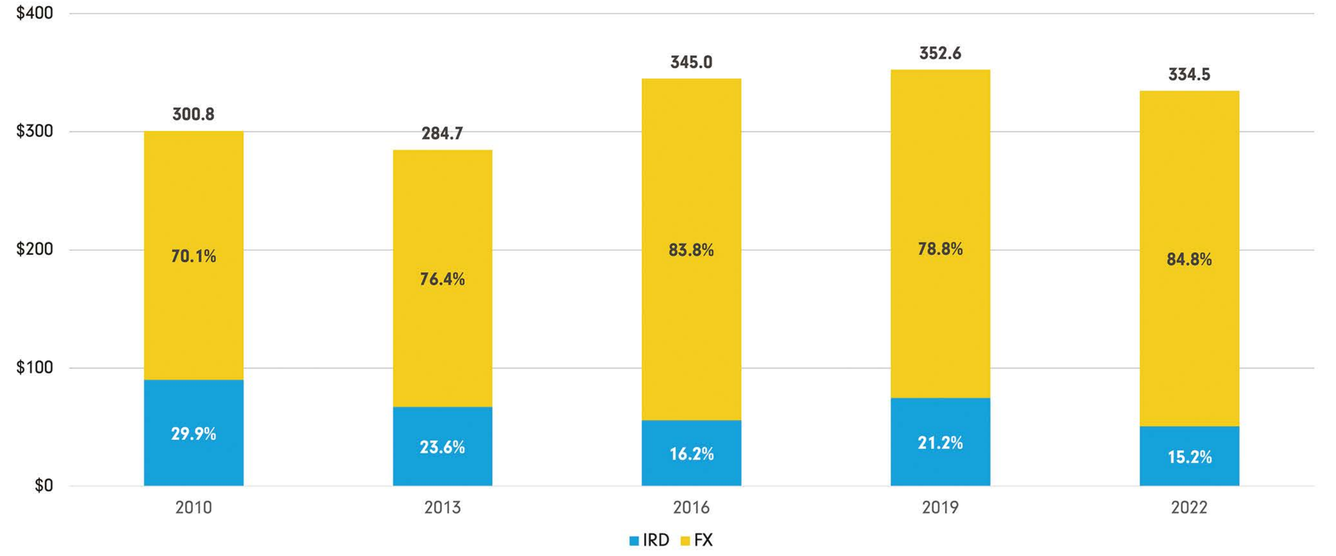
"The yen has diverged significantly from purchasing power parity. It may be because Japan doesn't have a large enough credit market to absorb excess liquidity and domestic investors have been rather sceptical on the Japanese stock market, so the excess liquidity created by these measures found its way abroad. The most significant side effect has been the malfunctioning of the JGB market, which no longer reflects Japan's potential growth and inflation," says Naka Matsuzawa, chief strategist in the market strategy research department at Nomura.

Derivatives impact

The past eight years of unconventional monetary policy have had many consequences, including constrained growth of Japan's derivatives market. Average daily turnover of over-the-counter (OTC) FX and interest rate derivatives reported by sales desks in Japan totalled $334.5 billion in April 2022, down 3% from $345.0 billion in April 2016, according to the BIS triennial survey (see Chart 1).

While global OTC FX derivatives average daily turnover grew from $4.5 trillion to $7.2 trillion between →

CHART 1: OTC FX DERIVATIVES AND IRD AVERAGE DAILY TURNOVER REPORTED BY SALES DESKS IN JAPAN (US$ BILLIONS)



2016 and 2022, Japan's share of that turnover fell from 6.5% to 4.0%. Meanwhile, average daily turnover reported by sales desks in Asia Pacific increased from $1.3 trillion in April 2016 to $1.9 trillion in April 2022, but Japan's share of this turnover fell from 23.0% to 15.0% during that time. Having held the largest share of the FX derivatives market in the region in 2010, Japan was trailing Singapore and Hong Kong by 2022 (see Chart 2).

Average daily turnover of FX derivatives reported by sales desks in Japan fell to $283.8 billion in 2022, down from $289.1 billion in 2016. FX swaps accounted for the lion's share, comprising 72.2% of turnover in April 2022, with forwards and options accounting for 22.0% and 4.3%, respectively.

Notwithstanding the fall in FX derivatives turnover in Japan and the recent depreciation of the yen, trading of the currency around the world has increased steadily over the past decade. Global average daily turnover of FX derivatives with the yen on one side of the trade reached $814.3 billion in April 2022, up from $700.6 billion in 2016 and $455.1 billion in 2010. This accounted for 7.5% of global FX derivatives turnover in 2022, making the yen the third most traded currency in the world, after the US dollar and the euro.

In the interest rate derivatives market, Japan's share of global average daily turnover dropped to 0.9% in April 2022, down from 1.8% in 2016 and 3.4% in 2010. Within Asia Pacific, average daily turnover reported by sales desks increased from $298.4 billion in April 2016 to $684.6 billion in April 2022, but Japan's share of this turnover fell from 18.7% to 7.4%. Having held the largest share of the interest rate derivatives market in the region in 2010, Japan was trailing Hong Kong, Singapore and Australia by 2022 (see Chart 3).

Average daily turnover of interest rate derivatives reported by sales desks in Japan fell to $50.7 billion in April 2022, down from $55.9 billion in April 2016. Swaps accounted for the majority of interest rate derivatives transactions, comprising 95.6% of turnover in April 2022, with options and other interest rate derivatives accounting for 4.0%.

Ready for reversion

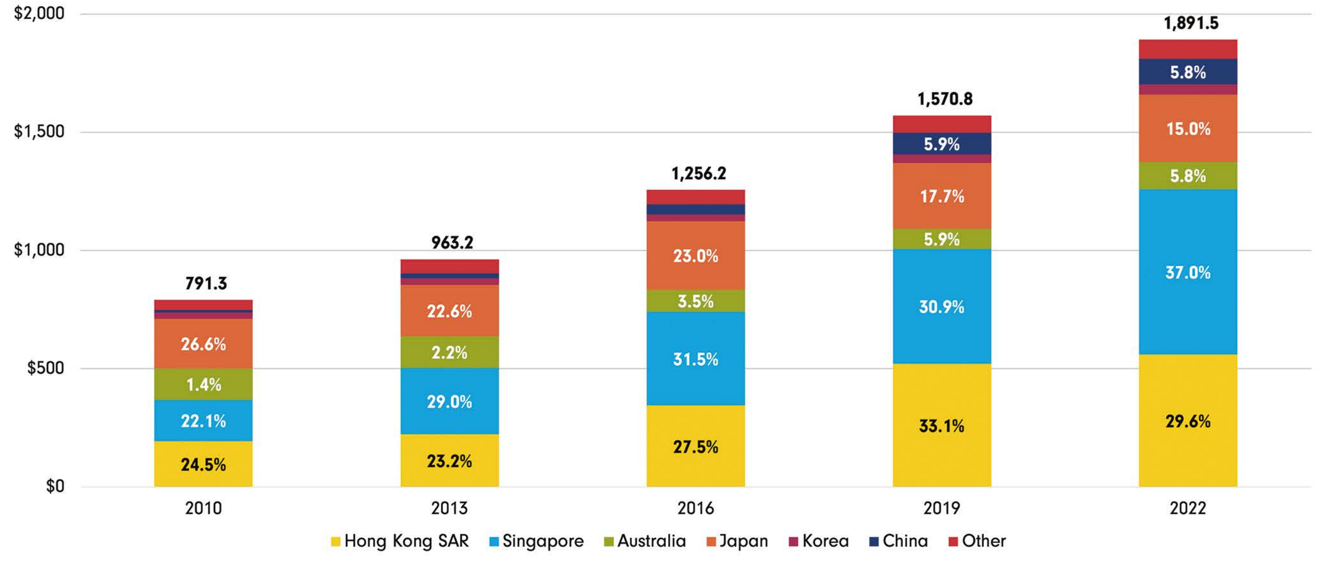
The BIS data shows the impact of the negative interest rate and YCC policies on Japan's FX and interest rate derivatives market, but the tide is expected to turn now that those policies have come to an end. Speaking to **IQ**, senior market participants said they have been preparing for a normalisation of monetary policy and expect new opportunities will follow (see pages 22-25).

"The change in monetary policy is a major shift for all market participants in Japan and it's clear from our members that this is expected to bring both challenges and opportunities. Firms have been looking to make sure they have the necessary in-house expertise to manage rising interest rates, but there is also a sense that more volatility and a more active derivatives market will bring an increase in derivatives market turnover that has been lacking in recent years," says ISDA's Morita.

As with the removal of any long-term policy measure, it may take time for the full implications to be felt and there could be further bumps in the road. For example, Nomura's Matsuzawa believes the removal of negative interest rates and YCC may not lead to an immediate gain in value for the yen.

"The BoJ will be hoping that the exit from these measures will bring excess liquidity back to Japan and the yen will at least stabilise, if not get closer to purchasing power parity.

CHART 2: FX DERIVATIVES AVERAGE DAILY TURNOVER BY LOCATION OF SALES IN ASIA-PACIFIC (INCLUDING JAPAN) (US$ BILLIONS)

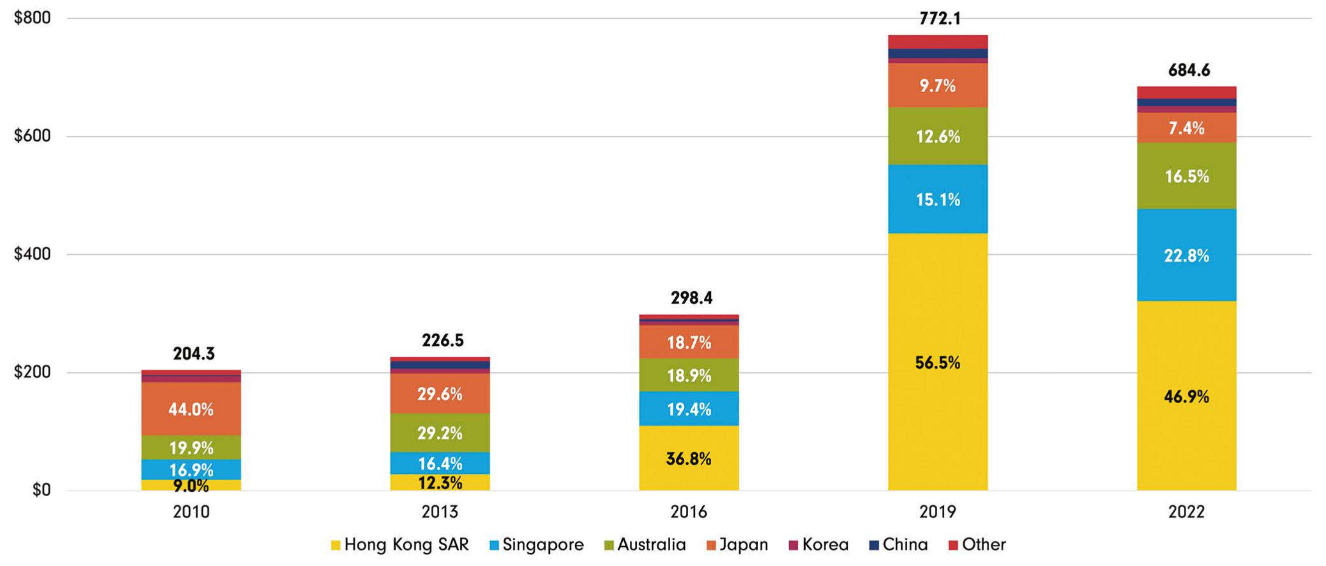


The challenge is that the so-called 'stock effect' of monetary easing may keep driving the yen lower for some time after the BoJ starts to withdraw excess liquidity, and that will excessively inflate the economy and bring government bond yields unnecessarily higher," Matsuzawa explains.

For Japanese households and businesses, the shift in policy opens the door to using short-term investments, rather than having to hold money with banks. But an environment of rising interest rates could also lead to new pressures, says Muguruma of Mitsubishi UFJ Morgan Stanley Securities.

"Now that the BoJ has ended YCC, the JGB yield curve is expected to shift upward, which would improve the profitability of Japanese banks. The challenge is that if the BoJ continues to hike interest rates, corporate loan rates and mortgage rates would go up. That might put financial stress on small- and medium-sized enterprises and households. Also, if the BoJ quickly reduces government bond buying or starts quantitative tightening aggressively, this would challenge Japan's fiscal sustainability," explains Muguruma. IQ

CHART 3: INTEREST RATE DERIVATIVES AVERAGE DAILY TURNOVER BY LOCATION OF SALES IN ASIA-PACIFIC (INCLUDING JAPAN) (US$ BILLIONS)



* Building for the Future

Japan's Financial Services Agency is working to promote Japan as a centre for asset management, as well as contributing to work to address vulnerabilities in the financial system and enhance sustainability disclosures, explains ***Shigeru Ariizumi****, vice minister for international affairs*

IQ: Can you describe the Financial Services Agency's (FSA) priorities for 2024, both from a domestic and global perspective?

Shigeru Ariizumi (SA): Under the Japanese presidency of the Group of Seven (G-7) last year, Japan highlighted key issues to enhance the resilience of the global financial system, including lessons learned from the banking turmoil in March 2023, crypto assets and stablecoins, sustainability disclosures, transition finance and natural disaster risk finance.

Building on that, our current priorities are in four areas. First, advancing the ongoing work of the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision to learn lessons from the banking sector turmoil in March 2023. Second, addressing vulnerabilities in non-bank financial intermediation (NBFI). Third, implementing effective regulatory and supervisory frameworks to address financial stability and macro-financial risks posed by crypto assets and stablecoins, including through the globally consistent and effective implementation of the FSB's high-level recommendations finalised in July 2023. And fourth, addressing climate-related financial risks, including enhancing sustainability disclosures and promoting transition finance. The FSA will continue to contribute to international discussions and related work.

Further to this, disaster risk finance continues to receive global attention and the work on natural disaster protection gaps by the International Association of Insurance Supervisors (IAIS) is relevant in this context. As chair of the IAIS Executive Committee, I look forward to building on the IAIS report published in November 2023, in addition to finalising the Insurance Capital Standard by the end of 2024.

Another key initiative, and perhaps most important for the FSA, is our policy plan for promoting Japan as a leading asset management centre. This policy aims to achieve a virtuous cycle of growth and distribution, in which we will encourage Japan's household savings, which account for more than half of household financial assets in Japan, to shift into productive investment. In turn, the benefits of increased corporate value will be returned to households, leading to further private-sector investment and consumption. Under

"Another key initiative, and perhaps most important for the FSA, is our policy plan for promoting Japan as a leading asset management centre. This policy aims to achieve a virtuous cycle of growth and distribution"

this initiative, the FSA expanded the Nippon Investment Savings Account, a tax exemption scheme for retail investors, and made it permanent from this year.

Turning to the corporate sector, which has accumulated large cash and deposit holdings that are not being invested, we have been advancing corporate governance reform, moving from form to substance. In addition, the FSA will work on reforming the asset management sector and asset ownership in Japan. This is not a one-shot initiative, and it will be important to steadily implement measures in the medium to long term. The FSA hopes this will lead to economic transformation, particularly by realising a virtuous cycle of growth and distribution.

IQ: Following recent market shocks, global policymakers have been addressing the risks associated with NBFI, focusing on liquidity, leverage and margin. What do you think should be the policy priorities?

SA: Given that approximately half of total global financial assets are held by the NBFI sector and the share of NBFI in the overall financial system has been on an increasing trend, we need to carefully monitor and assess the financial stability risk posed by NBFI.

The G-7 Finance Ministers and Central Bank Governors (FMCBG) meeting communiqué under Japan's G-7 presidency last year supported the work of the FSB and standard-setting bodies to enhance the resilience of NBFI, including promoting implementation of the FSB money market fund (MMF) policy proposals and addressing structural liquidity mismatches in open-ended funds (OEFs). They are now working to address vulnerabilities in NBFI leverage and enhancing margining practices in centrally cleared and non-centrally cleared markets. The work on leverage will be a particular challenge as the scope can be quite broad, with the potential for rapid developments. Given the potential risks and vulnerabilities in the NBFI sector, the FSB and standard-setting bodies have been taking a comprehensive approach and the work is still ongoing.

First, liquidity management. Building on the lessons from the market turmoil in March 2020, international discussions have intensified on activities that could give rise to liquidity mismatches, which are particularly prevalent in some types of non-bank entities, such as MMFs and OEFs.

For MMFs, the FSB finalised policy proposals in 2021 to enhance money market fund resilience, which laid out vulnerabilities of MMFs in light of the market turmoil in March 2020. The policy proposal aimed to enhance the resilience of MMFs, including through risk monitoring and assessment. Last year, a stock-taking exercise was conducted to determine the extent to which these policy recommendations were implemented in each jurisdiction.

As for OEFs, the FSB and the International Organization of Securities Commissions (IOSCO), of which I am vice chair, published final recommendations and guidance on anti-dilution liquidity management tools in December 2023, which aim to achieve significant strengthening of liquidity management by OEF managers. The FSB and IOSCO will review implementation progress and, in 2028, assess whether the implemented reforms have sufficiently addressed financial stability risks.

Second, the FSB's work relating to NBFI leverage. This may have significant implications as it involves cross-sectoral work and covers both financial and synthetic leverage. Data gaps continue to be an issue in advancing NBFI work and addressing this is an important and challenging topic.

Finally, the work related to margin. In September 2022, the Basel Committee, the Committee on Payments and Market Infrastructures (CPMI) and IOSCO published a report, *Review of Margining Practices*, which identified six areas for further policy work in both centrally cleared and

"It is crucial to implement the Basel III framework in a globally consistent manner. We are concerned about deviations and implementation delays in some jurisdictions and are monitoring these developments closely"

→ non-centrally cleared markets. The Basel Committee and CPMI-IOSCO, along with the FSB as part of its work programme on NBFI, are working together to carry out the work recommended in the report. The FSA is contributing to this policy work as a member of all three working groups.

This year, CPMI-IOSCO and the Basel Committee have jointly released a consultation paper for their respective work, which includes policy recommendations on margin. The recommendations aim to address the procyclical behaviour of market participants through margin calls in times of market stress, as seen during the dash for cash, Archegos and the liability-driven investment shock.

I would like to emphasise two points on the work on margin. Firstly, it is challenging for financial regulators to implement all policy recommendations, given the definition of NBFI entities includes market participants in a wide range of sectors, some of which are not even subject to financial supervision. Secondly, these initiatives should be implemented from a holistic perspective, balancing effects in both centrally cleared and non-centrally cleared markets. We need to make sure our approach maintains incentives for market participants to trade derivatives transactions at centrally cleared markets.

IQ: The FSA will implement changes to its derivatives reporting rules in April, incorporating international data standards. How are Japanese entities preparing for these rule changes, and how effective do you think they will be in improving derivatives market transparency?

SA: After the CPMI-IOSCO publication of over-the-counter (OTC) derivatives data elements in October 2019, the FSA amended the Financial Instruments and Exchange Act (FIEA) in 2020 to reflect international standards for aggregating OTC derivatives trade reporting data into trade repositories.

After the FIEA revisions, the FSA amended the 'Cabinet Office Order' to expand OTC derivatives trade reporting by including additional data elements. More specifically, from April 2024, there will be a requirement to report legal entity identifier (LEI), unique transaction identifier (UTI) and critical data elements, such as mark-to-market value and the amount of margin/collateral per transaction. From April 2025, unique product identifier will be required to be reported.

For a smooth implementation of our regulatory amendments, the FSA has had a continuous exchange of views with market participants. To ensure trading systems will incorporate the new reporting requirements, the FSA has been working closely with market participants and the Depository Trust and Clearing Corporation's Japan data repository.

The FSA expects these initiatives will contribute to improving the transparency of the overall OTC derivatives market. Furthermore, implementation of the LEI and UTI requirements will enhance the visibility of individual transactions.

The potential use of OTC derivatives trade data will be further explored by the international group that is currently working on topics related to leverage and margin in the NBFI sector. The FSA will consider leveraging the expanded trade repository data for monitoring OTC derivatives markets, including participants from the NBFI sector.

IQ: The final parts of the Basel III framework take effect for some Japanese banks this month (March 2024), and the requirements are largely consistent with the Basel Committee standards. Are you concerned by the deviations some jurisdictions have taken, and will this make it difficult to achieve a globally consistent framework?

SA: Japan is taking a phased approach to Basel III implementation, allowing banks to implement the rules from March 31, 2023, and requiring internationally active banks to implement them by March 31, 2024. The FSA will continue to promote the implementation of Basel III while engaging with stakeholders.

IOSCO'S GLOBAL AGENDA

IQ: In addition to your role at the Financial Services Agency (FSA), you are also vice-chairman of the International Organization of Securities Commissions (IOSCO) and chair of the IOSCO Asia-Pacific Regional Committee (APRC). What are the key issues you are addressing at IOSCO?

Shigeru Ariizumi: As vice-chairman of the IOSCO board, I would like to mention IOSCO's key issues – mainly, financial innovation, sustainable finance and non-bank financial intermediation.

IOSCO recently published two important reports on fintech – the crypto and digital asset (CDA) recommendations and a report on decentralised finance. We have also seen other international bodies, such as the Group of 20, the Financial Stability Board (FSB) and the Financial Action Task Force (FATF), publish guidance, reports and recommendations related to financial innovation. Following the publication of the CDA recommendations, the implementation process will begin this year in each jurisdiction. Given the risks of regulatory arbitrage due to the cross-border nature of crypto assets, it will be extremely important to implement the recommendations with a sense of urgency. With IOSCO having resource constraints, close collaboration with other international organisations like the FSB and FATF will be needed.

As an integrated regulator, the FSA has been involved in discussions on crypto assets at international groups, including the FSB, IOSCO and the FATF. Taking advantage of our broad mandate, we aim to promote collaboration between international organisations. In particular, as chair of the IOSCO APRC, I see opportunities to advance collaboration with the FSB Regional Consultative Group for Asia. As vice chair of the IOSCO board, I also expect IOSCO's Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU) to be widely used in exchanging information on crypto assets.

On sustainable finance, IOSCO announced its endorsement of the International Sustainability Standards Board (ISSB) standards (S1 and S2) last July. The FSA contributed to the analysis as a key member of the relevant working group. IOSCO's 130 member jurisdictions, which regulate more than 95% of the world's financial markets, will consider ways in which they might adopt, apply or otherwise be informed by the ISSB standards within the context of their jurisdictional arrangements.

It is becoming increasingly important to ensure the reliability, consistency and comparability of sustainability information. IOSCO has been working on sustainability assurance, closely engaging with the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA). In March 2023, IOSCO published its *Report on International Work to Develop a Global Assurance Framework for Sustainability-related Corporate Reporting*. In December 2023, IOSCO released a statement that welcomed the IAASB's consultation on the Proposed International Standard on Sustainability Assurance 5000 and the global outreach programme.

In addition, the IESBA published two exposure drafts (EDs) related to sustainability assurance: *International Ethics Standards for Sustainability Assurance (including International Independence Standards)* ED, which includes revisions to the existing code related to sustainability reporting, and *Using the Work of an External Expert* ED, and launched a public consultation on the EDs in January 2024. IOSCO will continue its work in collaboration with the IAASB and the IESBA, including on the evaluation of international standards related to sustainability assurance.

As chair of the APRC, I would like to emphasise the importance of the exchange of information among regulators at the regional level. The APRC consists of 24 regulators and nine associate members from the Asia-Pacific region. Given the diversity of regulations and supervision within the region, the APRC is an important forum to discuss key issues at the IOSCO board, as well as to convey regional perspectives to the board's discussions.

Furthermore, a new APRC supervisory MMoU framework was established in October 2022. The APRC supervisory MMoU is the first of its kind in IOSCO, which aims to strengthen supervisory cooperation in the Asia-Pacific region. As chair of the APRC, the FSA has played a leading role in introducing and promoting the supervisory MMoU. In contrast to the IOSCO MMoU, in which the scope of information exchanged is limited to law enforcement purposes, the APRC supervisory MMoU enables the exchange of information for supervisory purposes. As of the end of January 2024, 12 of the 24 authorities in the APRC region had already signed the supervisory MMoU and have been exchanging information based on this framework. I would like to promote its further use to facilitate supervisory cooperation in Asia Pacific.

Looking globally, the banking turmoil last year was the most significant system-wide stress since the global financial crisis. The most important lesson from the turmoil is that financial regulatory reforms after the crisis have played a significant role in ensuring the resilience of the banking system as a whole. From this perspective, it is crucial to implement the Basel III framework in a globally consistent manner. We are concerned about deviations and implementation delays in some jurisdictions and are monitoring these developments closely. In particular, implementation delays in some jurisdictions potentially pose risks and challenges for others, such as level playing field issues and increased regulatory costs due to the unavailability of data from third-party vendors necessary for internal models that calculate market risk. These delays may also lead to market fragmentation, which was intensively discussed by the Group of 20 (G-20) and the FSB under the Japanese G-20 presidency in 2019.

As the Group of Central Bank Governors and Heads of Supervision members unanimously reaffirmed to be their expectation in September 2023, it is important to →

"As more financial institutions commit to net zero, it has become increasingly important to promote corporate disclosure of relevant information about sustainability-related risks and opportunities"

implement all aspects of the Basel III framework in full, consistently and as soon as possible.

IQ: Financial institutions and regulators around the world have made commitments to support the transition to net zero. How much progress has been made in Japan, and what role will the FSA play in future policy in this area?

SA: Japan has been an early advocate of the role of transition finance to achieve net zero, and its importance was emphasised at the G-7 summit in Hiroshima last year.

First, the FSA convened a working group of experts and published a guide on the work of financial institutions toward net zero last year, pointing out their pivotal role in engaging with their clients. The guide identified financed emissions as a key element to promote transition finance. A temporary increase in financed emissions is expected to be explained with a high degree of credibility in their business plans, along with the outlook for emissions reduction supported by the actions of financial institutions and their clients.

Last year, Japan advocated during its presidency of the G-7 for the importance of credible information, and the G-7 FMCBG meeting communiqué highlighted the importance of enhancing the availability and credibility of data that contributes to promoting transition finance.

It is also important to promote the development of actual use cases on transition finance. To achieve this, we are planning to launch the Asian GX Consortium in the first half of this year. The consortium will gather a wide range of partners, including financial institutions in Asia and the Glasgow Financial Alliance for Net Zero. This initiative aims to drive green transformation investments, including transition finance, through dialogue between the public and private sectors. Japan will lead international discussions on transition finance through such initiatives and contribute to the decarbonisation of Asia and the rest of the world.

For financial institutions to make steady progress in transition, it is also essential to aggregate the climate-related data needed to track and analyse progress. It is necessary to build a foundation to collect data for the entire supply chain, particularly for scope-three emissions.

Specifically, Japanese regional financial institutions have started to support the measurement and reduction of emissions by small- and medium-sized enterprises that are suppliers to major manufacturers. In collaboration with the Ministry of the Environment, the FSA has supported these financial institutions in measuring their clients' emissions, which will be a basis for their scope-three emissions. Through these efforts, the FSA will continue to promote the accuracy and transparency of supply chain emissions.

As more financial institutions commit to net zero, it has become increasingly important to promote corporate disclosure of relevant information about sustainability-related risks and opportunities, which would serve as the foundation for open and constructive dialogue with investors and market participants.

From this perspective, the FSA has adopted two initiatives. First, the FSA worked with the Japan Exchange Group on the amendment of the Corporate Governance Code in June 2021. The code now calls for companies listed on the prime market of the Tokyo Stock Exchange, which covers 96% of market capitalisation, to enhance sustainability-related disclosure based on the Task Force on Climate-Related Financial Disclosures recommendations or an equivalent framework.

Second, the FSA is promoting sustainability-related disclosures in statutory disclosure documents. A new section is included to provide explanations about sustainability-related matters in annual securities reports and companies are required to disclose this information from the financial year ending March 2023.

Following the June 2023 finalisation of the International Sustainability Standards Board standards (General Requirements for Disclosure of Sustainability-related Financial Information and Climate-related Disclosures: S1 and S2), the Sustainability Standards Board of Japan is developing domestic sustainability-related disclosure standards, equivalent to the S1 and S2, to be finalised by March 2025 with subsequent implementation.

This interview with Shigeru Ariizumi took place on March 1, 2024

A New Normal

The reversion of the Bank of Japan's negative interest rate and yield curve control policies heralds a new normal for Japan's derivatives market. **IQ** *talks to a panel of senior market participants about their expectations for the coming months*

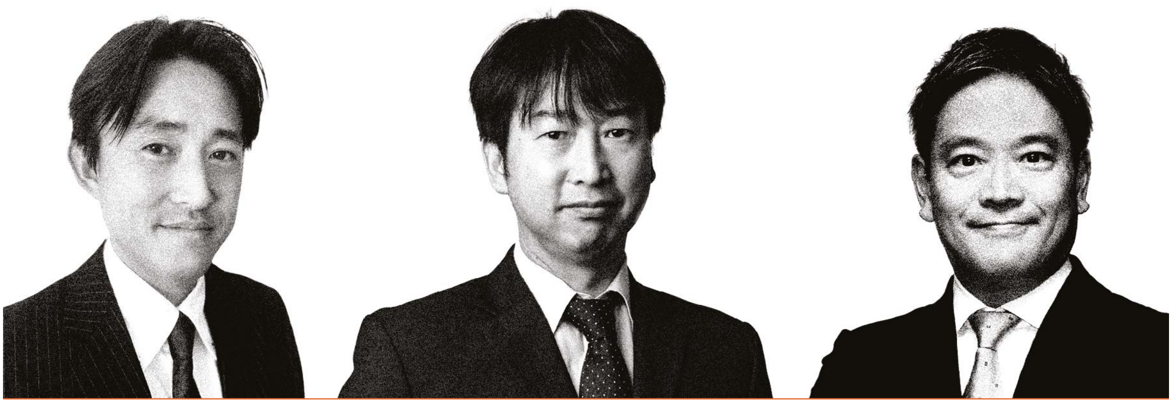
IQ: What are the biggest opportunities and challenges for participants in the Japanese derivatives market this year?

Yoji Imafuku (YI): During the era of negative interest rates and yield curve control (YCC) policies between 2016 and 2024, it can be argued that the Bank of Japan (BoJ) effectively had full control over Japanese government bonds (JGBs) and Japanese yen interest rates. Consequently, the ability of market participants to determine interest rate levels based on macroeconomic factors and market sentiment has been rendered inert. Significant dysfunction in the short-term interest rate market has been evident and, for many firms, there is a scarcity of personnel with experience from a time when the market functioned properly.

On the other hand, investors from Europe, the US, the Middle East and other regions are increasingly showing interest in JGBs as an attractive asset and are seeking various investment ideas, including derivatives. As the BoJ's monetary policy normalises, the use of derivatives for risk management and improved investment returns will be globally recognised and more active trading is expected to resume.

Shigeru Nonomura (SN): For participants in Japan's derivatives market, it is essential to adapt to a new market environment, including responding to the termination of the negative interest rate and YCC policies. For instance, following a prolonged period of low volatility, it is necessary to review risk management systems. Simultaneously, participants need to reduce costs and analyse the impact on their business through the introduction of artificial intelligence and the enhancement of IT infrastructure. Additionally, the Japanese government is seeking to further develop Japan as an international financial hub.

THE PARTICIPANTS



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"As the BoJ's monetary policy normalises, the use of derivatives for risk management and improved investment returns will be globally recognised and more active trading is expected to resume"

Yoji Imafuku, Mizuho Securities

Hideki Ushida (HU): The BoJ has now lifted its negative interest rate policy for the first time in eight years. In response, the Japanese yen interest rate is likely to become more volatile and the derivatives market is expected to become much more active. On the other hand, there are fewer market participants and traders that have experienced a phase of rising yen interest rates. In addition, the environment surrounding derivatives has become more advanced and complex due to the use of clearing houses and the introduction of margin regulations. In these circumstances, financial institutions are already working on human resource development as a significant issue. Market participants and traders with skills and experience in yen interest rates have become more valuable in the job market.

IQ: What trends do you anticipate in the yen interest rate and foreign exchange (FX) markets this year, and how might they impact investors?

HU: There are two major factors that influence the BoJ's monetary policy. One is wage increases that exceed inflation (the spring labour negotiations) and the other is the US economy and the timing of the Federal Reserve's interest rate cuts.

SN: We have now seen the simultaneous removal of the negative interest rate and YCC policies. Additionally, I expect the 10-year bond yield to rise to 1.0% by the end of 2024, while the US 10-year bond yield is expected to fall to 4.2% by year-end, resulting in a forecasted USD/JPY exchange rate of ¥143 by December 2024. As markets continue to normalise, investors may need to reposition their portfolios and adjust their risk profiles for normalisation.

YI: As a means of normalising monetary policy, we have now seen the first rate hike from the BoJ. In contrast, gradual interest rate cuts are expected to take place in Europe and the US after 2024 as their price indices are now being stabilised. Due to the differences in the direction of monetary policy, there is a possibility that the yen may outperform the dollar and other currencies.

On the other hand, considering the BoJ's stance that stable inflation of around 2% is a condition for the normalisation of monetary policy, it may be difficult to raise interest rates much further, particularly if there is no tangible evidence of a positive trend in real wages. The increased burden on small- and medium-sized enterprises caused by interest rate hikes may also delay further increases. YCC fulfilled its substantive role in BoJ monetary policy, so the decision to cease this policy coincided with the removal of negative interest rates.

In an era of positive interest rates, the relative value of yen credit will be in better shape than that of foreign currency investments for domestic investors due to the high cost of hedging FX risks, an improvement in supply and demand, and the expectation of spread tightening. For foreign investors, as interest rates in each country decline and their own currencies weaken, the attractiveness of investing in Japanese bonds is expected to increase. Investors that expect yen rates to rise may also take short positions in JGBs.

IQ: US dollar LIBOR was finally phased out in 2023, but benchmark reform efforts are still in progress, with a recent announcement by JBA TIBOR Administration that it will cease publication of euroyen TIBOR at the end of December 2024. What impact has IBOR transition had on the Japanese market?

YI: Efforts to unify TIBOR into TONA are underway and there is an optimistic outlook that the transition can be smoother than initially anticipated. Although domestic TIBOR still remains, completing the transition to risk-free rates (RFRs) would be positive for market participants. They are now fully aware of the benefits of →

"Despite some challenges that need to be overcome, we believe digital solutions can play a very important role in the ongoing revisions to transaction reporting regulations"

Hideki Ushida, MUFG

the simple RFR structure compared to TIBOR, which requires the pricing of term premiums, and it is expected to be an effective tool for risk management in a period of rising interest rates.

IQ: Japanese rules to implement the remaining Basel III measures, including the Fundamental Review of the Trading Book (FRTB), take effect this month (March 2024) for some Japanese banks. What impact will the implementation of these rules have on derivatives markets?

SN: After the introduction of the FRTB, we expect a drop in the adoption of the internal models approach (IMA) for market risk by the major banks. Of the firms that decide to adopt the IMA, they will most likely cover less than 50% of total risk-weighted assets (RWAs) for market risk, with the rest using the standardised approach (SA), according to an ISDA survey conducted late last year. As firms move away from existing Basel 2.5 internal models and adopt the FRTB SA, we expect a reduction in the use of exotic derivatives, especially those that generate large residual risk add-on capital charges from correlation risk. Moreover, the difference in overall risk sensitivity between the IMA and SA will likely change the risk drivers of market risk RWAs and hence the allocation across risk classes in general.

HU: In Japan, the remaining Basel III measures, including the FRTB, are scheduled to be introduced from the fiscal year ending March 2024. Most financial institutions are expected to adopt the SA, changing the method for measuring market risk RWAs, and it is assumed that the current internal management methods for market risk will remain as they are. Under these circumstances, while regulatory capital and internal risk management methods will be separated, trader behaviour is expected to be unchanged due to the focus on internal risk management, which has very limited impact on the derivatives market. Japanese financial institutions are steadily preparing and there seems to be no dissatisfaction with the fact that the regulations will be introduced ahead of other countries.

YI: In our firm, RWAs for market risk are significantly less than credit risk RWAs related to lending, and the increase in market risk RWAs after the introduction of the FRTB will not be a material constraint on risk-taking activities in global markets. From the perspective of capital policy, the group has already incorporated the impact of Basel III internally based on a complete implementation of the capital floor, so the impact of derivatives-related RWAs on the entire group is not expected to have a material effect on our activities.

We are in the final stage of aligning our business operating model with newly introduced FRTB requirements, such as the boundary between the trading book and the banking book and the internal risk transfer desk. We're making good efforts to establish new policies and procedures globally, one year ahead of other jurisdictions, to keep our operations fully compliant with the Financial Services Agency's (FSA) FRTB rules.

IQ: Japanese regulators will implement amendments to regulatory reporting rules in April 2024 to incorporate globally agreed critical data elements. What will these changes mean for financial institutions? Can digital solutions help with implementation?

HU: Revision of the transaction reporting regulations in April 2024 is expected to bring Japanese regulations up to the global standard. Behind these movements is global harmonisation among authorities in each country to suppress financial systemic risk.

However, from the perspective of financial institutions, implementation of the rules requires IT development and leads to increased costs. Financial institutions are therefore required to respond efficiently while ensuring accuracy and speed when responding to requests from authorities. Despite some challenges that need to be overcome, we believe digital solutions can play a very important role in the ongoing revisions to transaction reporting regulations in various countries. In addition, we believe that how authorities use transaction reporting data is a very important element in achieving the ultimate goal.

SN: I expect that regulatory authorities' understanding of the over-the-counter derivatives market will further improve with the addition of critical data elements that are not currently included in existing reporting requirements. Financial institutions are also working on improving the quality of reporting data by revising process controls and enhancing data governance. A unique challenge in Japan is that some reporting parties that previously opted to report directly to the FSA will need to submit their trade data to a trade repository following the implementation of the new FSA rules in April. This will require significant changes to processes and systems.

Looking ahead, there is an expectation that use of machine-readable technology will lead to standardisation of legal requirement interpretations across the market and will streamline the adaptation to regulatory changes within organisations. I am closely monitoring the development of these digital solutions.

IQ: Your firms have all been represented on the ISDA board of directors. What role does ISDA play in Japan?

SN: Over the past decade, ISDA in Japan has played a leading role on a global scale, particularly in areas such as capital regulations and the permanent cessation of panel LIBOR. Looking ahead, I expect ISDA to take on a role in revitalising the derivatives market in a true sense. This will likely involve streamlining and reducing costs through digitisation, as well as adapting to the latest market developments.

HU: ISDA is making a significant contribution to ensuring the soundness and transparency of the derivatives market and maintaining an efficient market environment. In Japan, we have recently started to see some transactions involving environmental, social and governance (ESG) products, such as voluntary carbon credits and sustainability-linked derivatives. Japan is less developed than Europe and the US in terms of laws, regulations and accounting relating to these products, which is hindering future market expansion. In this context, ISDA Japan launched an ESG working group in January 2021, and is carrying out information dissemination, sharing and exchange of opinions with potential market participants, as well as lobbying activities with related authorities such as the FSA and the Ministry of Economy, Trade and Industry.

YI: ISDA has played a pivotal role for more than two decades in expanding its membership and promoting the use of the ISDA Master Agreement and credit support annexes among Japanese financial institutions and end users. We also host several workshops and seminars for member and non-member firms every year to foster compliance with regulations such as margin requirements and trade reporting, as well as industry-standard risk management practices and capital calculation.

IQ: Delegates at the ISDA Annual General Meeting (AGM) on April 16-18 will be busy attending sessions and meeting industry colleagues, but if they have time to do just one thing in Tokyo during their visit, what would you recommend?

YI: It is the Meiji Shrine, which is known for having the highest number of visitors on New Year's Day and is dedicated to Emperor Meiji, the 122nd emperor of Japan. It is a solemn and historic shrine with a beautiful exterior, located in a lush green forest and well known as a sacred site. From the Meiji Shrine, you can walk to Harajuku and Omotesando, which are the centres of Japanese pop culture. Also, Shibuya is just one train stop away, where you can find almost everything about Japanese fashion, music, anime, manga and art. These areas are adjacent to the AGM venue in Roppongi, offering a variety of delicious food such as ramen, traditional Japanese cuisine, sweets and more.

HU: While it's not just one thing, I think you can enjoy Japan's world-class service – 'omotenashi', meaning hospitality – wherever you go. You can feel omotenashi in hotels, restaurants and even convenience stores. For baseball fans, I would like them to enjoy the world-class Japanese baseball – Nippon Professional Baseball (NPB) – which won the World Baseball Classics last year, and the unique Japanese support with trumpets and cheering songs.

SN: I would also recommend watching professional baseball. The massive contract of Shohei Ohtani with the Los Angeles Dodgers in the Major League Baseball's Hot Stove League recently made headlines as one of the biggest contracts in the history of professional sport. NPB is one of the major sports in Japan and you can experience the difference in culture between the West and Japan by participating in united cheering at Japanese baseball stadiums. Whether you are familiar with baseball or not, I think you will enjoy it. In Tokyo, both the Tokyo Dome and Jingu Stadium are easily accessible, so it would be a good idea to choose one that fits your travel schedule. IQ


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TUESDAY, APRIL 16	
9:00 AM	**ISDA Accounting Symposium: Digital Assets, ESG, DRM, Hedge Accounting and More** Sponsored by EY
11:00 AM	**ISDA CDM-Digital Regulatory Reporting (DRR) Roundtable**
12:15 PM	**ISDA CDM-Collateral Roundtable**
12:45 PM	**ISDA Symposium: Breaking the Glass** How to Manage Contract and Operational Risk During a Termination
1:00 PM	**The Future for Japan's Financial Markets** This exclusive briefing, supported by the Financial Services Agency of Japan, will explore new policy initiatives to develop Japan's asset management business, as well as opportunities available to global and local buy- and sell-side institutions. **This event is invitation only**
4:00 PM	**Early Registration & Arrival Hospitality Lounge** Sponsored by S&P Global
7:30–10:00 PM	**ISDA AGM Welcome Reception at Zouk Tokyo** Sponsored by LSEG Post Trade
WEDNESDAY, APRIL 17	
7:55 AM	**Registration, Networking Breakfast & Exhibition Opens**
8:55 AM	**Opening Remarks** *Scott O'Malia*, Chief Executive Officer, ISDA
9:10 AM	**Keynote Address** *Teruhisa Kurita*, Commissioner, Financial Services Agency, Government of Japan
9:25 AM	**The Global Market Outlook** Economies around the world have faced rising inflation, higher interest rates and slowing growth, but the tide looks to be changing in some jurisdictions, with inflation falling from its highs. What's the outlook for the global economy and what will this mean for derivatives markets and trading strategies?
9:55 AM	**Navigating Geopolitical Risk** Geopolitical risks have had a big influence on market dynamics and prices – and with conflicts continuing around the world and a number of elections due in 2024, this is likely to continue. How can firms navigate the current environment, and what issues do they need to be aware of?
10:35 AM	**Networking Break**
11:05 AM	**Interview** *Rostin Behnam*, Chairman, US Commodity Futures Trading Commission
11:25 AM	**Taking Aim at NBFI** Regulators have highlighted non-bank financial intermediation as a sector that warrants closer review and have initiated several workstreams aimed at addressing perceived vulnerabilities. What steps are regulators planning to take and what will this mean?
12:10 PM	**Managing Disruption** Recent events like Russia's invasion of Ukraine have highlighted the difficulty of managing risks during periods of geopolitical upheaval. ISDA is working on two key initiatives in response, including a review of the 1998 FX and Currency Option Definitions and an industry notices hub for the delivery of critical notices to counterparties.
12:55 PM	**Lunch**
2:05 PM	**Keynote Address** *Masahiko Kato*, President & CEO, Mizuho Bank, Ltd.
2:20 PM	**The Global Impact of US Treasury Clearing** The US Securities and Exchange Commission has finalised rules that will require increased clearing of cash US Treasury securities and repos. Given the critical role US Treasuries play in the global financial system, what impact will this change have on global liquidity and market structure?
3:05 PM	**Keynote Address** *Tom Montag*, Chief Executive Officer, Rubicon Carbon
3:20 PM	**Networking Break**
3:50 PM	**Counting the Cost of Capital Reforms** All major jurisdictions have now published proposed rules to implement the final Basel III measures. The various national rule sets diverge in some areas, but all put greater reliance on standardised approach models. US prudential regulators estimate their proposed measures will result in an estimated 75% increase in capital for market risk. How will these changes impact trading businesses, and how are banks adapting?
4:35 PM	**Keynote Address** *Marco Casalaina*, Vice President of Products, Azure AI, Microsoft
5:00 PM	**Day 1 General Sessions Conclude**
5:00 PM	**ISDA + Women in Financial Markets Reception & Panel Discussion** Future of Derivatives Markets: Shaken or Stirred?
7:30–10:00 PM	**ISDA AGM Reception at Happo-en** Sponsored by Mitsubishi UFJ Financial Group, Mizuho and Nomura

Agenda is subject to change

THURSDAY, APRIL 18	
7:50 AM	**Registration, Networking Breakfast & Exhibition Continues**
8:40 AM	**Welcoming Remarks** *Scott O'Malia*, Chief Executive Officer, ISDA
8:45 AM	**Chairman's Remarks** *Eric Litvack*, ISDA Chairman, Managing Director, Group Director of Public Affairs, Société Générale
9:00 AM	**Keynote Address** *Raymond F. Greene*, Deputy Chief of Mission, US Embassy in Japan
9:15 AM	**Keynote Address** *Seiichi Shimizu*, Executive Director, Bank of Japan
9:30 AM	**View from the Trading Desk** What's shaping trading strategies in 2024? How are firms responding to the current macroeconomic and market environment?
10:15 AM	**Reporting Rule Rush** Regulators in Japan amended their derivatives regulatory reporting requirements on April 1 to incorporate globally harmonised critical data elements, and regulators in the EU, UK, Australia and Singapore will follow suit this year. Will the changes increase the consistency of reported data and create efficiencies at reporting firms? What else needs to happen for the data that's reported to be truly useful for regulators?
10:55 AM	**Networking Break**
11:20 AM	**Implementing Digital Transformation** Implementing digital solutions can bring significant efficiencies to legal and post-trade processes, helping to reduce costs, but overcoming internal inertia and making a compelling case for the switch can slow implementation. This session will look at how firms have approached digital adoption and the benefits it has brought.
12:00 PM	**Keynote Address** *Yutaka Nakajima*, Deputy President Director, Representative Executive Officer, Nomura Holdings, Inc.
12:15 PM	**Clearing and Margin Practices** Sponsored by JSCC Regulators are looking closely at margin practices, procyclicality, transparency and margin collection processes. What changes might be on the agenda, and what steps will central counterparties take in response?
1:00 PM	**Board of Directors Election/Financial Report** **MEMBERS ONLY**
1:00 PM	**Lunch**
2:15 PM	**POLICY SPOTLIGHT SESSION A** **Tackling Greenwashing in Carbon Markets** Voluntary carbon markets can complement corporate carbon reduction strategies, enabling firms to buy carbon credits to offset those emissions they can't reduce now, but the threat of greenwashing threatens to hamper this market. This session will explore industry initiatives to set standards for high-quality carbon credits and establish standard definitions and documentation, as well as the steps regulators are taking to clamp down on malpractice in this market.
	POLICY SPOTLIGHT SESSION B **The Asia-Pacific Legal and Regulatory Agenda** This panel will discuss significant legal, public policy and regulatory objectives in Asia-Pacific. Panelists will also explore the legal and regulatory steps that emerging market and developing economies globally and in the region are taking to promote the development of safe and efficient local capital and derivatives markets.
3:05 PM	**POLICY SPOTLIGHT SESSION A** **Initial Margin Resiliency: A Moving Target** Market volatility and the application of initial margin requirements for non-cleared derivatives to smaller counterparties have prompted global regulators to re-examine the robustness of non-cleared initial margin models and their responsiveness to market stress, prompting new global expectations on model design, calibration and validation. This panel will explore these requests, the corresponding evolution of the ISDA Standard Initial Margin Model and the impact on global market participants.
	POLICY SPOTLIGHT SESSION B **Developments in US, EU and UK Public Policy** Regulators in the US, EU and UK have ambitious agendas, ranging from a review of block thresholds in the US to modifications to derivatives trading, clearing, reporting and transparency rules in the EU and UK. Panelists will discuss the most pressing issues, challenges and potential solutions.
3:55 PM	**POLICY SPOTLIGHT SESSION A** **The Future for CDS** Credit derivatives gross market value is well below its 2008 peak, but credit default swaps continue to serve as an important hedging tool for lenders and investors. What changes could be made to ensure this market remains robust in the face of changing economic and market conditions?
	POLICY SPOTLIGHT SESSION B **Appetite for Disruption** How can generative artificial intelligence improve key functions in derivatives markets, including research and analytics, collateral, risk management, document review and the application of data standards? Members of ISDA's Future Leaders in Derivatives programme will discuss the opportunities and challenges, including some of the ethical dilemmas that might arise.
4:40 PM	**Exhibitor Farewell Cocktails**
5:45 PM	**ISDA AGM Concludes**

Agenda is subject to change

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Growing the Gateway

Hong Kong's Securities and Futures Commission is working to promote the city's role as a gateway to China, while also strengthening the resilience of markets. Chief executive officer ***Julia Leung*** *talks to* **IQ** *about her agenda since taking on the role last year*

IQ: You became chief executive officer of the Securities and Futures Commission (SFC) in January 2023, having previously served as deputy CEO since 2018. What have been your priorities?

Julia Leung (JL): As the capital market regulator, the SFC's top priority is to further strengthen the resilience of our markets and mitigate harm to investors.

To cite a few examples relevant to derivatives traders, we have enhanced clearing house default fund coverage for the futures market to the two largest participant groups as an ongoing effort to enhance the resilience of exchanges and clearing houses. Our ability to monitor the underlying trades has been enhanced with the implementation of the investor identification regime for the Hong Kong securities market, launched in 2023. We have kept in view the risk situation of the markets and removed the statutory position limits and reporting requirements for contracts based on international indices and underliers, which have limited impact on the local and mainland markets. However, Hong Kong Exchanges and Clearing Ltd (HKEX) will continue to set position limits and reporting requirements for these contracts in its trading rules for proper risk management.

Enhancing the global competitiveness and appeal of Hong Kong capital markets is on our agenda. The SFC has pursued a two-pronged strategy to bolster Hong Kong's status as an asset management and global fundraising centre. The first prong is to deepen our capital market's connection to the mainland through broadening mutual market access. Launching Swap Connect and mainland treasury bond futures are some of the examples. The other prong is to diversify our sources of investors and issuers, such as those from the Association of Southeast Asian Nations and the Middle East. The listing of the world's largest exchange-

"Given rapidly developing technological innovation, it is more important than ever for us to ensure that new financial technology is used in a responsible, compliant and secure manner. We believe responsible technological innovation can promote transparency and efficiency in financial markets, as well as improve investor experience"

traded fund (ETF) to track Saudi Arabian equities on Hong Kong's stock exchange in November 2023 was a good example.

We also actively steer the transformation of financial markets through technology and environmental, social and governance (ESG) initiatives. For ESG, our top priority is to bolster Hong Kong's position as a leading sustainable finance hub through the local adoption of global corporate sustainability disclosure standards (ie, the International Sustainability Standards Board standards) and develop a healthy ESG ecosystem. As a responsible organisation, the SFC has committed to achieving carbon neutrality by 2030, in line with the Hong Kong government's strategy, and taken measures to meet an interim target of a 50% reduction in its total carbon emissions by 2030.

Given rapidly developing technological innovation, it is more important than ever for us to ensure that new financial technology is used in a responsible, compliant and secure manner. We believe responsible technological innovation can promote transparency and efficiency in financial markets, as well as improve investor experience. The SFC strives to foster a technology-neutral regulatory environment that encourages innovation without compromising market integrity. To actively support the development of Web 3.0 and foster growth of the fintech community in Hong Kong, the SFC became a pioneer in regulating the virtual assets industry by launching a new licensing regime for virtual assets trading platforms in Hong Kong in June 2023. In addition to allowing the offering of virtual-assets-related futures ETFs, virtual-assets-related spot ETFs and tokenised investment products, we recently updated guidelines for intermediaries by specifying applicable requirements and the standards of conduct expected of them to facilitate the industry's virtual-assets-related activities.

IQ: China has made major efforts to liberalise its capital markets and remove barriers to international investors in recent years. As the international gateway to China, Hong Kong has a big role to play in the development of Chinese markets. How is the SFC supporting this mission?

JL: As a global financial centre and the premier gateway to the vast mainland markets, Hong Kong plays a pivotal role in the opening of China's financial market. In particular, the various mutual market access schemes, from mainland-Hong Kong Stock Connect to Bond Connect, ETF Connect and Swap Connect, have enlarged the investor base for markets in both Hong Kong and the mainland. These programmes will be expanded further.

Celebrating its 10th anniversary in 2024, Stock Connect has been a successful model for allowing the mainland's capital market to access international capital. By enabling investors in Hong Kong and mainland China to trade securities in each other's market through a mutual access system, the scheme has helped to increase the flow of capital between Hong Kong and mainland China and promote the internationalisation of the renminbi (RMB). As of late December 2023, stocks covered in Stock Connect represented about 86% of the two markets' combined market capitalisation. Net inflows from the mainland to the Hong Kong stock market reached about RMB2.53 trillion ($325 billion) for southbound trading, while there has been RMB1.75 trillion in northbound trading by overseas investors since debut.

The SFC has also been developing risk management tools for institutional investors to manage their exposures to A shares and mainland bonds. After the launch of Swap Connect in May 2023, we are exploring the extension of similar infrastructure and close-out netting to onshore repurchase agreements, giving overseas investors a way to finance their RMB bond holdings, as well as cross collateralisation. In mid-2023, →

"As a global financial centre and the premier gateway to the vast mainland markets, Hong Kong plays a pivotal role in the opening of China's financial market"

→ the SFC reached a consensus with the China Securities Regulatory Commission to introduce block trading under Stock Connect, which will further enhance trading efficiency.

At the same time, we can see the rapid internationalisation of RMB. As the mainland's economy has grown significantly in recent years to become the second largest in the world, it has led to an increase in demand for RMB-denominated products and services as investors seek to gain exposure to China's economic growth. In addition, the RMB has become a major reserve currency. Playing a key role in the internationalisation of RMB, the SFC has been developing a range of financial products denominated in RMB in the past few years, including RMB-denominated bonds and ETFs.

IQ: The launch of the Swap Connect northbound trading channel last year allows overseas firms to trade and clear offshore RMB interest rate swaps via Hong Kong without changing their trading and settlement practices. How important do you think this new initiative is, and how has it performed so far?

JL: As the first mainland-Hong Kong mutual market access programme for financial derivatives products, Swap Connect provides an efficient channel for foreign investors to manage the RMB interest rate risk through the mainland interbank interest rate swap (IRS) market. It is a milestone in the expansion of the Connect scheme to derivatives, bolstering Hong Kong's position as a risk management hub and encouraging foreign participation in the mainland bond market.

Since its launch in May 2023, Swap Connect has operated smoothly. The average daily volume of IRS contracts executed under the scheme has grown steadily, driven by both an increase in the number of foreign investors and their increased level of participation. Most of the foreign investors are international banks and some are asset managers. As of December 2023, the month-on-month average daily notional value of contracts executed under Swap Connect amounted to HK$6.7 billion ($857 million), representing an increase of about 100% from the initial period in May. Following the launch of Swap Connect, total foreign holdings of mainland bonds under northbound Bond Connect increased by 9% in the seven months to December 2023.

IQ: What further partnerships and initiatives would you like to see between Hong Kong and mainland market infrastructures to facilitate access to China's markets for international participants?

JL: Since the launch of Stock Connect in 2014 and Bond Connect in 2017, we have made several enhancements to improve the depth and breadth of the Connect schemes. Stock Connect currently covers more eligible securities, with coverage in terms of trading now exceeding 80% in both Hong Kong and mainland markets, and allows holiday trading. The launch of the ePrime service under Bond Connect facilitates northbound primary subscription of new bond issues by overseas investors.

With increasing participation of foreign investors in the mainland market, the MSCI China A 50 Connect Index futures were launched in 2021 to meet foreign investors' needs to manage their risk exposures in A shares. The launch of Swap Connect provides a convenient way for overseas investors to manage their RMB interest rate risk. We also recently announced that Hong Kong will launch China treasury bond futures, which will complement Swap Connect to help facilitate foreign investors' hedging of mainland interest rate risks. We believe that further development of risk management products is crucial to support the growth of the Connect schemes.

We also see the importance of providing a mechanism for investors to use their share and bond holdings for other purposes. As such, we may consider other initiatives such as stock borrowing and lending and the use of holdings for collateral purposes. These initiatives will require further linkage between infrastructures in the two markets.

IQ: Global policymakers have been assessing the risks associated with non-bank financial intermediation (NBFI) and central counterparty (CCP) resilience following the dash for cash in March 2020 and other liquidity shocks. What has the SFC been doing to address this issue?

JL: Working with other global policymakers, the SFC has been focusing on some areas to enhance the resilience of the NBFI sector. Among these is the important role we play in the development of international policies relating to the liquidity management of open-ended funds (OEFs). The SFC's executive director of investment products, Christina Choi, is serving a second term as chair of the International Organization of Securities Commissions' Committee on Investment Management and has been leading the committee's core experts

JULIA LEUNG ON DERIVATIVES TRADE REPORTING

IQ: Jurisdictions around the world have updated their derivatives reporting rules to incorporate international data standards and facilitate more effective reporting of trades. What further steps can be taken to enable accurate and efficient aggregation of data in Hong Kong?

Julia Leung: Hong Kong has implemented the over-the-counter (OTC) derivatives reporting regime in phases since July 2015. While the first phase covered interest rates swaps and non-deliverable forwards, the second phase in July 2017 expanded the product scope to cover derivatives in all five key asset classes – namely, interest rates, foreign exchange, equities, credit and commodities. In a bid to address market feedback and cater to regulatory needs, we enhanced our equity reporting templates and made the unique transaction identifier's data field available in December 2022. These efforts aim to keep our OTC derivatives reporting regime relevant and up to date.

To facilitate the aggregation of OTC derivatives data through standardisation and harmonisation of data elements, Hong Kong will undergo a data harmonisation exercise very soon. We will also adopt the aligned principles and data format set out in the various technical guidance published by the Committee on Payments and Market Infrastructures (CPMI).

Furthermore, to integrate OTC derivatives data across jurisdictions, we plan to adopt the ISO 20022 XML message format standard in our upcoming data harmonisation exercise, following the recommendation of CPMI and the International Organization of Securities Commissions (IOSCO). The standard is required by US and EU authorities for OTC derivatives reporting and is also proposed for adoption by major Asia-Pacific authorities. It will be desirable for Hong Kong to be part of the international community adopting the same message format standard.

Despite international efforts to standardise OTC data reported to trade repositories, the reported data in different jurisdictions may vary due to discrepancies in market practices, operations, regulations and investor profiles. Hong Kong has therefore established its own trade repository, Hong Kong Trade Repository (HKTR), so we can take into account the local market situation and capture the OTC activities and information most relevant to risk monitoring in the Hong Kong market. The HKTR data have been extremely useful for our normal market monitoring and for market events such as the Archegos incident.

Before making meaningful risk assessments, the HKTR data must go through some rule-based verification, cleansing and enrichments, which are standard procedures across regulators. For instance, we promptly follow up with reporting participants to ensure data accuracy when noticing any outliers or substantial changes in the data and conduct thematic reviews on the OTC reporting of major participants. To avoid double counting – due to back-to-back trades, for example – we filter out relevant transactions based on the unique transaction identifier or the economic details of transactions and standardise the names of counterparties and the tickers of underlying securities. We also determine the long and short positions of counterparties according to their roles, group the relevant counterparties and aggregate their OTC positions across various affiliates for better risk assessment.

We believe that a consistent approach to data analysis among regulators is important. Following the Archegos incident, the Securities and Futures Commission (SFC) presented to IOSCO its monitoring framework of the OTC positions of Archegos using HKTR data. We subsequently co-chaired a workstream jointly established by IOSCO and the Financial Stability Board to develop common templates and measures to assess the potential concentration risks of OTC swap positions at the prime broker, counterparty and underlying levels. In this way, regulators can adopt a consistent approach to analysing OTC activities in their home markets through these common templates, thereby facilitating cross-border intelligence sharing.

Apart from the hard data, qualitative analysis of OTC activities is essential for a holistic assessment of potential risks. The SFC therefore collects intelligence from various types of market participants to assess potential risks to market stability. We appreciate the cooperation of market participants, which is key to future enhancements to the OTC derivatives reporting regime.

group in conducting relevant work on OEFs. In Hong Kong, a well-established regulatory framework for the liquidity risk management of funds is in place as funds marketed to retail investors must be authorised by the SFC and comply with the SFC's Code on Unit Trusts and Mutual Funds, which sets out the obligations of management companies of SFC-authorised funds to maintain and implement effective liquidity risk management policies and procedures.

While SFC-authorised money market funds in Hong Kong actually received positive net subscriptions during the stress periods in March 2020, we have been monitoring regulatory developments relating to money market funds and considering enhancements in local requirements to strengthen their resilience.

Noting that leverage is another potential structural vulnerability arising from asset management activities, we have been monitoring international regulatory developments relating to leverage in funds. To better monitor the leveraging situation, SFC-authorised funds are required to calculate the fund leverage arising from derivatives investments according to the methodology and guidance published by the SFC.

To better assess potential issues relating to funds, the SFC performs regular monitoring on the risk exposure of Hong Kong-domiciled SFC-authorised funds and requires asset managers to periodically →

→ report key data, including subscription and redemption flows, liquidity profiles, asset allocations and securities financing and borrowing transactions. Since November 2021, we also collect data on the use of leverage, credit quality and currency exposure to strengthen our monitoring of fund activities and better understand developing trends in financial markets.

In addition to closely monitoring the liquidity of SFC-authorised funds through reports from asset managers of unusual or untoward activities, we stay abreast of market developments and tailor our monitoring programme in response to different market circumstances and stress events, such as the fallout from the Russia-Ukraine conflict and the uncertainty of the US and European banking sectors. We assess the potential risks that are arising and actively engage with asset managers to monitor and assess the impact on funds.

In March 2020, large increases in aggregate margin requirements in both the centrally cleared and non-centrally cleared markets raised issues about the potential high liquidity pressure generated by the margin process. Since then, the SFC has been working with global policymakers in some working groups relating to CCP margin practices to review and formulate potential policy changes.

The SFC will continue to ensure HKEX fulfils international standards on CCP risk management on an ongoing basis, including the principles for financial market infrastructures (PFMIs). In fact, the SFC has required HKEX to go beyond the minimum standards set out under the PFMIs in certain respects. Moreover, the SFC has been continuously working with HKEX to improve its CCP resilience and risk management. In 2022, HKEX rolled out a new risk model for the cash market to more precisely size collateral requirements from its participants against their exposures. In 2023, at the SFC's request, HKEX enhanced its clearing house default fund coverage for the futures market from the first plus fifth largest clearing participants to the two largest participant groups, known as Cover 2. HKEX is working to extend the Cover 2 policy to the cash market and is exploring the possibility of introducing more routine intraday margin calls in the derivatives market.

With our robust risk management system, CCPs in Hong Kong have demonstrated strong resilience in previous crises and high volatility periods during the past few years. IQ

JULIA LEUNG ON THE CARBON MARKET

IQ: Carbon markets are widely seen as an important complementary tool to achieve net-zero emissions targets, but concerns about greenwashing could constrain the market's growth. How big a role can carbon markets play in the transition to net zero, and what steps has the Securities and Futures Commission (SFC) taken to stem greenwashing and improve trust?

Julia Leung: Carbon trading is a key tool to mobilise finance for the transition to a low-carbon economy. In the case of compliance markets, it is a market-based mechanism to provide carbon pricing to incentivise heavy emitters to reduce greenhouse gas emissions by shifting to cleaner energy sources, reduce overall energy use and invest in clean technologies for their operation and supply chain partners. Voluntary markets support the decarbonisation efforts of companies outside of compliance schemes and provide a platform to mobilise private finance to scale transition though carbon capture technologies and nature-based solutions.

With an immense estimated size, mainland China's carbon markets show great promise – the infrastructure is ready, with the national exchange and multiple local pilot programmes in place. In addition, market interest in voluntary carbon markets globally has grown significantly, driven by the potential impact of the EU carbon border adjustment mechanism and similar schemes being considered in the UK and Australia, corporate social responsibility, and the surge in the number of companies and countries setting climate goals.

The launch of Core Climate, an international carbon marketplace, by Hong Kong Exchanges and Clearing Ltd in October 2022 provides transparency in the trading of voluntary carbon credits and instruments in Asia and beyond. This is a milestone in Hong Kong in helping connect global capital to the mainland's climate-related products and opportunities.

In addition, the SFC has stepped up its efforts to combat greenwashing and increase market transparency, with a view to addressing investors' information needs for making informed decisions. The SFC was one of the first regulators in the region to require fund managers to consider climate risks in their investment and risk management processes and make proper disclosures effective in November 2022. It also enhanced its environmental, social and governance (ESG) fund disclosure requirements in 2021. On an ongoing basis, we maintain a public central database of SFC-authorised ESG funds on our website and work closely with our subsidiary, the Investor and Financial Education Council, to raise investor awareness of sustainable investment.

To introduce corporate sustainability disclosure requirements in Hong Kong, the SFC has been working with government bureaus, relevant authorities and stakeholders to develop a roadmap for adopting the International Sustainability Standards Board standards, taking account of local regulatory expectations and circumstances. Adopting these standards will provide investors with a wealth of reliable, comparable and consistent corporate information in this space.

As announced in October 2023, the SFC supports and sponsors the development of a code of conduct for voluntary adoption by ESG ratings and data product providers in Hong Kong, which will help strengthen the transparency, quality and reliability of ESG information available for making investment decisions.

MISSION STATEMENT

ISDA fosters safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products

STRATEGY STATEMENT

ISDA achieves its mission by representing all market participants globally, promoting high standards of commercial conduct that enhance market integrity, and leading industry action on derivatives issues.

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Advancing practices related to trading, clearing, reporting and processing of transactions in order to enhance the safety, liquidity and transparency of global derivatives markets

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Rethinking the Endgame

Analysis of US proposals to implement the final parts of the Basel III framework has shown capital requirements for traded assets would increase on a scale that could reduce capital markets liquidity and negatively impact the real economy

When global policymakers convened at the Basel Committee on Banking Supervision to redesign the regulatory capital framework in response to the global financial crisis, they probably didn't expect it would take more than 15 years to complete the job. The last components of the framework, which include capital requirements for market risk and credit valuation adjustment (CVA) risk, are now being finalised in each jurisdiction, but analysis shows proposals to implement the rules in the US could result in capital increases on a scale that would negatively affect financial markets and the real economy.

Following publication of a notice of proposed rulemaking (NPR) by the US Federal Reserve, the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency in July 2023, ISDA and the Securities Industry and Financial Markets Association (SIFMA) conducted a quantitative impact study (QIS) with input from eight US global systemically important banks (G-SIBs) to determine the impact of the proposals on traded assets. The results show the transition from the current US standardised approach to the proposed expanded risk-based approach (ERBA) would lead to an estimated 129% increase in market risk and CVA risk-weighted assets (RWAs).

This would come on top of already significant increases in capital since the financial crisis. According to analysis by PwC, US G-SIBs have raised their common equity tier-one capital from approximately $244 billion in 2008 to $881 billion by the end of 2022. In a joint response to the NPR submitted by ISDA and SIFMA on January 16, a series of calibration changes were proposed to render the rules more risk sensitive and appropriate. It will now be down to the US agencies to determine what changes should be made to the framework.

"If capital levels aren't aligned with risks and returns aren't enough to offset capital costs, then banks will either choose to scale back from that business or raise costs. Neither are good outcomes for end users – particularly as

"Higher costs and reduced availability of funding will have a knock-on impact on US economic growth. If appropriate revisions to the calibration cannot be achieved without further consultation, a re-proposal of the rules may be necessary. We simply have to get this right"

Scott O'Malia, ISDA

> "It is important not to lose sight of the possible consequences of the Basel III rules as proposed in the US, which could lead to a less resilient financial system, in which banks are unable to provide critical intermediation services"

Mark Gheerbrant, ISDA

the business lines that will be most affected are those critical to financing and hedging. Higher costs and reduced availability of funding will have a knock-on impact on US economic growth. If appropriate revisions to the calibration cannot be achieved without further consultation, a re-proposal of the rules may be necessary. We simply have to get this right," says Scott O'Malia, chief executive of ISDA.

73%-112%

Estimated increase in market risk RWAs for US G-SIBs

Global divergence

The US was one of the last major jurisdictions to publish its proposed rules, so the NPR marks a critical milestone on the road to completion of the Basel III reforms, giving market participants clarity on the differences between the approaches of individual countries and regions. Although the rules are not yet final, significant discrepancies have emerged between how the US and other jurisdictions intend to implement the standards. These differences relate to both the timing of implementation and the content of the rules.

A fragmented approach to implementation deadlines might not be a problem for domestic entities that only need to adhere to a single set of rules, but it can create complexity and distortions for internationally active banks. Although the Basel Committee had anticipated a globally aligned implementation, individual jurisdictions have subsequently set their own timelines. The rules are due to apply to some Japanese banks from March 2024, while EU banks will begin implementation from January 1, 2025. The US agencies proposed to implement their rules on July 1, 2025, and the UK Prudential Regulation Authority has now set the same deadline, six months later than it had originally proposed.

For G-SIBs and other large banks that operate in multiple jurisdictions, there are two main concerns over timing. First, the staggered deadlines will mean complying with different sets of rules at different times. Second, the ongoing uncertainty over the final rules in the US means there could be insufficient time between finalisation and implementation for banks to complete the necessary compliance and approval processes.

Given the volume of feedback on the US NPR and the potential need for revisions, market participants have suggested the mid-2025 deadline may be unrealistic. In their response to the NPR, ISDA and SIFMA recommended the rules should become effective no earlier than 18 months from publication of the final rule to ensure banks have sufficient time to implement the requirements.

"If we get the final rule at some point this year, implementation will begin from that point onwards and it will take banks time to adapt. For the use of internal models, there will be new methodologies and processes and we will have to go through validation, review and examinations with supervisors, all of which will take time and resources. That is on top of the work required to implement the new standardised approach for market risk and the CVA framework. There is a huge resource requirement for both the industry and regulators and managing this in a short time frame will be a real challenge," says a senior risk manager at a US bank.

One of the key features of the revised market risk rules – known as the Fundamental Review of the Trading Book (FRTB) – is the more onerous capital model approval process, which would require desk-level sign-off from supervisors. This is expected to lead to greater use of standardised approaches, which will become more complex and risk sensitive than previous iterations. Even those banks that opt to use internal models will face restrictions. In a key deviation from the Basel standards, US regulators have removed the option for banks to use internal models for credit risk, which includes the calculation of capital for the default risk charge and counterparty credit risk. →

> "If banks have to hold so much more capital, that will increase the cost of trading, with reduced liquidity and diminished returns for investors of all sizes. Banks will struggle to continue offering certain products, with movement outside the banking system and overseas. These are pretty serious implications"

Debbie Toennies, JP Morgan

→ According to the results of the ISDA/SIFMA QIS, market risk capital requirements would increase by between 73% and 112%, reducing the return on capital by an estimated 42-53%. The magnitude of the capital increase will ultimately depend on the extent to which banks use internal models. If banks significantly reduce their use of internal models, as expected, then the increase will be closer to 112%.

Speaking on the publication of the NPR in July 2023, Federal Reserve chair Jerome Powell acknowledged the proposed rules would increase capital requirements beyond the Basel Committee standards and what other large jurisdictions have proposed. He also recognised that the very large increase in market risk RWAs "requires us to assess the risk that large US banks could reduce their activities in this area, threatening a decline in liquidity in critical markets and a movement of some of these activities into the shadow banking sector".

Banks echo these concerns, arguing that a 73%-112% increase in market risk capital does not reflect levels of risk and will make it harder and more costly for banks to offer intermediation and risk management services, reducing the liquidity of US capital markets and making it more expensive for US businesses to raise funding.

"For many years, regulators have generally suggested the overall level of capital in the US system is just about right for the largest banks. This proposal would lead to such a material increase in capital that it's tough to square that, particularly when G-SIBs have performed well during recent stresses, with no significant shortfall in capital. If banks have to hold so much more capital, that will increase the cost of trading, with reduced liquidity and diminished returns for investors of all sizes. Banks will struggle to continue offering certain products, with movement outside the banking system and overseas. These are pretty serious implications," says Debbie Toennies, managing director and head of regulatory affairs for the corporate and investment bank at JP Morgan.

Recalibration recommended

As the US proposal stands, capital requirements for trading and capital markets activities would be determined by the proposed ERBA. In their joint response to the NPR, ISDA and SIFMA urge US agencies to consider how the proposal would interact with other prudential requirements, particularly the stress testing framework and the G-SIB surcharge.

The joint response also recommends a series of calibration changes to improve the risk sensitivity of the framework and avoid an adverse effect on liquidity in US capital markets. These recommendations fall into four key areas – the FRTB, CVA, securities financing transactions (SFTs) and clearing.

While US regulators have proposed that internal models would only be permitted for the FRTB, it is still expected that their use will decline dramatically because of the more stringent process for gaining approval and ongoing maintenance requirements. This includes the profit and loss attribution (PLA) test that is designed to ensure alignment between a bank's risk and front-office pricing models. Given the lack of actual portfolio data on the PLA test at this point, it is suggested that this should be converted to a qualitative requirement that is used only for supervisory monitoring for the time being.

Changes are also recommended to the non-modellable risk factor (NMRF) framework to allow greater recognition of risk diversification to create more alignment with actual risk exposure and risk management practices. Analysis suggests that improving diversification and making changes to improve the treatment of sovereign exposures when using internal models could reduce the capital impact by 20%.

"Addressing diversification has emerged as a key point of discussion for banks and regulators – it plays an important role because banks manage market risk in their portfolios across asset classes. Failing to properly recognise the diversification of risks can lead to a blunt approach, so improved recognition would result in more appropriate capital requirements for market risk," says Panayiotis Dionysopoulos, head of capital at ISDA.

The current standardised approach in the US does not include CVA risk capital, whereas the proposed ERBA – which is expected to become the binding constraint for most US G-SIBs – would. The inclusion of CVA RWAs under the ERBA will add significantly to capital requirements, but it is suggested that the impact could be reduced by 30% by adding greater granularity in the financial risk category and removing the client-facing leg of cleared derivatives transactions.

"Refining the CVA framework is particularly important for derivatives end users because the requirements as proposed would lead to increased costs and some products may become less readily available, which would affect the ability of end users to hedge their business risks. This would lead to weaker balance sheets and more volatile financial results, which would make firms less attractive to investors, increasing the cost of capital and borrowing. Given these potential knock-on implications, we would urge policymakers to revisit the treatment of CVA risk," says Lisa Galletta, head of US prudential risk at ISDA.

For SFTs, the QIS showed that the transition from the current standardised approach to the ERBA would increase RWAs by 18%. Given SFTs provide an important channel for firms to exchange funds in a low-risk and secure way, an increase in capital requirements would make it more difficult for market participants to raise financing. The increase in RWAs could be offset by the removal of the minimum haircuts floor, a formula that requires banks to collect a minimum amount of collateral from non-regulated financial institutions for certain SFTs.

"We appreciate the objective to address the risk of excessive leverage in the financial system, but there are conceptual and operational concerns that have prevented the minimum haircuts floor from being adopted in other jurisdictions, including Canada, the EU, Japan and the UK. The removal of this component of the framework would align the US with those jurisdictions and ensure the sustainability of banks' participation in this market," says Galletta.

In parallel with the response to the NPR, ISDA and SIFMA also replied to a separate Federal Reserve consultation on the G-SIB surcharge, raising concerns that the proposed revisions would lead to inappropriately high capital requirements for banks offering client clearing services. A separate QIS with input from six G-SIBs found that the proposals, especially the inclusion of notional amounts of client transactions cleared under the agency model in the complexity indicator within the surcharge, would increase capital by $5.2 billion. Combined with a $2 billion increase in capital for client clearing businesses as a result of the introduction of the ERBA, this would amount to an overall increase in capital for these client clearing businesses of 80%.

"Increasing capital for the provision of clearing services could discourage banks from offering these services, which would conflict with a long-standing policy objective to promote central clearing, particularly when the US Securities and Exchange Commission has just finalised rules to require greater clearing of US Treasury securities. That's why we have recommended the exclusion of client cleared exposures from the G-SIB surcharge, which would avoid inflicting high costs on a low-margin, systemically important business," says Ulrich Karl, head of clearing services at ISDA.

Decision time

Following completion of the QIS and submission of the consultation response on January 16, the baton has passed back to the US agencies to determine the path that should now be taken. Based on public statements both during and since the comment period, policymakers seem to recognise the significance of the task they now face. Speaking on January 17, Federal Reserve governor Michelle Bowman said due consideration must be given to the consequences of capital reform for the US banking industry, the economy and businesses.

"When policymakers consider changes to the capital framework, particularly increases of the magnitude contemplated in the proposal, we must carefully weigh the benefit of increased safety from higher capital levels with the direct costs to banks and the downstream effects on consumers, businesses and the broader economy. We must also consider the broader regulatory landscape and how changes to capital regulations may complement, overlap or conflict with other regulatory requirements," said Bowman.

At a more granular level, FDIC director Jonathan McKernan has suggested there may be a valid case for adjusting the timeline for implementation of certain parts of the framework to allow more time for testing and analysis. Speaking at ISDA's trading book capital conference in New York on December 12, 2023, he identified the FRTB's PLA test and treatment of NMRFs as two components that might benefit from further data collection to determine whether recalibration is needed.

"Delaying implementation of the underdeveloped aspects would allow time for a trial run of the rest of the framework. That would afford us an opportunity to gather data and conduct analysis to potentially recalibrate or otherwise improve the underdeveloped aspects. That also could permit us to disclose through subsequent rulemakings the rationale and evidence for our eventual US implementation," said McKernan.

It will be up to US policymakers to determine the roadmap towards implementation. In their response to the NPR, ISDA and SIFMA called for material changes to the calibration to ensure the rules are more appropriate and risk-sensitive and avoid adverse consequences for US capital markets. If that cannot be achieved without further consultation, a re-proposal of the rules may be necessary, they argued. The alternative would be increases in capital for bank trading activities that do not reflect underlying risks, forcing banks to scale back or withdraw from certain activities and businesses that become uneconomic.

"It is important not to lose sight of the possible consequences of the Basel III rules as proposed in the US, which could lead to a less resilient financial system, in which banks are unable to provide critical intermediation services. Since submitting our response to US agencies in January, ISDA has engaged with policymakers to discuss our recommendations and we will continue to do so, with the aim of improving the risk sensitivity of the framework," says Mark Gheerbrant, global head of risk and capital at ISDA.

Delivering on the DRR

With derivatives reporting rules set to be upgraded in Japan, the EU, the UK, Australia and Singapore this year, ISDA's Digital Regulatory Reporting initiative gives market participants the best chance of implementing the rules consistently and efficiently

Trade reporting is a straightforward concept with the potential to deliver unmistakable benefits, giving regulators a heatmap of market activity that can be used to identify emerging sources of systemic risk and take early action. The Group-of-20 (G-20) nations recognised this potential in 2009 when they committed to the reporting of all derivatives trades to designated repositories. But differences in reporting rules and practices across jurisdictions have led to widespread challenges, with inconsistencies, duplications and inaccuracies in reported data. The result is that derivatives market transparency is still a long way from what was intended.

Efforts are now underway to harmonise rule sets, and reporting rule changes are scheduled this year in five jurisdictions – Japan, the EU, the UK, Australia and Singapore. This follows similar changes implemented by the US Commodity Futures Trading Commission (CFTC) in December 2022, and involves the incorporation of global data standards known as critical data elements (CDEs), developed by the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO).

But this is only part of the answer. Even if each rule set is more consistent, firms still need to interpret those rules and make the necessary adjustments to their systems – and there's no guarantee those interpretations will be consistent from one organisation to the next. ISDA's Digital Regulatory Reporting (DRR) initiative has been designed to tackle this problem. By transforming a single industry agreed interpretation of the rules into machine-executable code, the DRR enables industry participants to implement the requirements consistently, without the need to devote resources and costs to interpreting and implementing each set of rules.

"We've had 10 years of regulators requiring more and more data, with the expectation that everyone has understood the rules in the same way so regulators can take this data and rely on it for various important purposes. Even though regulators are now being a lot more prescriptive in what they're asking for, with the CDEs giving a much more consistent version of what data points they need and how we should source those, there's still a lot of interpretation. It becomes very challenging for the industry to meet the expectations of the regulators as regards a consistent view of the data. But if you move to the DRR model, then you've got a code base that everyone can adopt, mitigating divergence in provision of the required regulatory data," says Eleanor Kelly, executive director, global regulatory change and control at JP Morgan.

Setting standards

Policymakers have long acknowledged the challenges associated with inconsistent rule sets, with the Financial Stability Board (FSB) tasking the CPMI and IOSCO to develop a globally harmonised set of data standards, including a unique transaction identifier, a unique product identifier and the CDEs.

Following the FSB mandate, the CPMI and IOSCO developed technical guidance for the CDEs, which would enable regulators to adopt them in their own jurisdictions, but it left individual agencies free to determine which data fields they should incorporate and the values and formats they would allow.

"The development of the CDEs is a positive evolution, but it's a huge list of data fields and leaves a lot of flexibility for regulators to pick what they want. Even if regulators were all to choose the same fields, there are different formats and values, so we still have the challenge of conflicting data across jurisdictions. ISDA continues to work with regulators to encourage greater consistency and clarity in the use of the CDEs, and we have developed the DRR to enable market participants to reduce interpretation risk when they implement the rule changes," says Tara Kruse, global head of derivative products and infrastructure at ISDA.

The CFTC was the first regulator to adopt the CDEs, bringing an initial round of changes to its swap data reporting rules into effect on December 5, 2022. Since then, participants in several other markets have been preparing for similar rule changes to take effect.

Japan's Financial Services Agency has set a deadline of April 1, with 139 data elements required to be reported from that date. This will be followed closely by the EU, where reporting rule changes will be implemented under the European Market Infrastructure Regulation Refit (EMIR Refit) on April 29.

The UK will implement its own version of EMIR Refit on September 30, while October 21 will see rules from the Australian Securities and Investments Commission and the Monetary Authority of Singapore come into force.

With five jurisdictions updating their reporting rules over the course of seven months, it's a critical period in the evolution of trade reporting, with many market participants having to comply with one or more new sets of rules in a short period of time. However, several key differences have emerged between the various requirements, making the implementation effort more challenging. In the EU and UK, for example, futures must be reported, but only over-the-counter derivatives are required to be reported in the US.

EMIR Refit increases the number of reporting fields from 129 to 203 in the EU and 204 in the UK. As it stands, the EU and UK will require both parties to a trade to report, although buy-side firms can delegate this responsibility to their sell-side counterparts. Dual-sided reporting can result in matching risk, when two parties report a trade in different ways, making it more challenging for the repository to reconcile the reports and ultimately affecting the accuracy of the data picture.

"Along with many of the other rule rewrites, EMIR Refit significantly increases the number of reportable fields. There's a lot more emphasis on the accuracy of the data, and on firms having controls in place to catch any errors and investigate any reconciliation breaks. The indication is that regulators will ask firms to prove they have the necessary processes and due diligence in place, so this is going to be a big change for reporting parties," says Andrew Bayley, senior director, data and reporting at ISDA.

"It becomes very challenging for the industry to meet the expectations of the regulators as regards a consistent view of the data. But if you move to the DRR model, then you've got a code base that everyone can adopt"

Eleanor Kelly, JP Morgan

Digital approach

ISDA's DRR initiative was developed to make the implementation process more efficient and cost-effective, enabling staff to be redeployed to other projects and reducing the risk of regulatory penalties for incorrect filings.

The DRR takes an industry interpretation of a particular rule set and turns it into open-access, machine-executable code using the Common Domain Model (CDM), a data standard for financial products, trades and lifecycle events.

That code can be used as the basis for implementation or firms can use it to compare the output with their own interpretation, validating that their approach is in line with the industry consensus and paving the way towards more effective, aligned implementation.

The first iteration of the DRR was developed to support the CFTC rule changes in 2022. Since then, ISDA has been working with its members to adapt the code to the specific requirements of other jurisdictions.

"When we started with EMIR Refit, we were able to reuse about 40% of the DRR code that had been developed for the CFTC rules. With Japan, we had around 75% in hand. The pace of development is picking up quickly because we've now written so much code for the US and EU. In the future, we could imagine a situation where the regulators themselves could issue new rules as code, which would allow changes like these to be published, interpretated and implemented much more quickly and consistently," says Bayley.

Having regulations issued as code that can be digitally adopted could open the door to significant benefits for both market participants and regulators that might ultimately extend well beyond trade reporting. In the immediate term, the global derivatives market has its work cut out to comply with the various new reporting rules that are set to be implemented in the coming months. If widely adopted, the DRR offers the best chance of achieving more consistent and accurate reporting in the 15 years since the original G-20 mandate.

"The CDM offers massive potential, much like SWIFT revolutionised our industry years ago. And the DRR is a perfect example of that potential. But to harness the benefits offered by the CDM and streamline our regulatory reporting processes with the DRR, widespread adoption across the industry is imperative. While the sell-side firms are relatively few in number, the buy-side firms are numerous, making it essential for these thousands of entities to embrace the CDM as well," says Emmanuel Geinoz, market infrastructure and derivatives expert, vice president, at Pictet Group. IQ

Read more about the DRR at www.isda.org/2023/04/04/drr-infohub/

For more information, contact CDMDRR@isda.org

Driven by Data

*Since joining the Commodity Futures Trading Commission as its first chief diversity officer, **Tanisha Cole Edmonds** has sought to use data to assess progress and set objectives on diversity, equity, inclusion and accessibility*

IQ: You joined the Commodity Futures Trading Commission (CFTC) at the start of 2022 as the agency's first chief diversity officer. What does the role entail and what milestones have you achieved so far to promote diversity and inclusion across the organisation?

Tanisha Cole Edmonds (TCE): As a member of the CFTC's executive leadership team reporting directly to the chairman, I oversee the Office of Minority and Women Inclusion (OMWI) and provide leadership and executive direction on the CFTC's efforts to integrate and promote diversity, equity, inclusion and accessibility (DEIA) at all levels of the agency's workforce and in our management and business operations. I also oversee the CFTC's equal employment opportunity programme.

On a day-to-day basis, my team and I are engaged in collaboration, consultation and advisory services, education, research and analysis. We use a data-driven approach to drive DEIA at the CFTC through quantitative and qualitative data collection, metric development, trend monitoring, report dissemination and delivery of training and educational programmes and resources to educate the CFTC workforce.

My work and that of my team is to uncover what agency policy, principles or practices may be driving the data and trends. We seek to understand and analyse what organisational and operational structures at the CFTC and embedded in its day-to-day procedures and practices may be barriers to creating a more diverse, equitable, inclusive and accessible organisation. I work in partnership with the CFTC's divisions and offices to ensure they receive relevant DEIA information that will influence better business decisions for the CFTC.

Through consultative sessions and check-ins with CFTC division/office directors, I aim to understand the unique needs of each division office, so my team and I can assess their specific DEIA needs and help develop a plan for customised DEIA services and strategies. These services and strategies can include a range of customised options, from toolkits and workshops to programmes that address division/office-specific DEIA workplace needs.

We liaise daily with a variety of agency stakeholders to provide advice and consultation to improve policy and process development and strategic thinking. We also manage change and enhance organisational culture and performance.

In my two years with the CFTC, we have achieved several milestones, including the development of an agency-wide DEIA vision statement, creation of DEIA performance standards for executives as part of the CFTC's executive performance management programme, and development of the CFTC's first standalone DEIA strategic plan, to be issued this year. We also implemented an outreach and engagement programme, including a strategic recruitment plan to proactively engage and recruit diverse top talent to the CFTC, and held a CFTC-wide career forum for recent graduates and early career talent.

"We seek to understand and analyse what organisational and operational structures at the CFTC and embedded in its day-to-day procedures and practices may be barriers to creating a more diverse, equitable, inclusive and accessible organisation"

IQ: On announcing your appointment, CFTC chairman Rostin Behnam noted that the CFTC continues to fall short on its Equal Opportunity Employer & Diversity Statement to support the recruitment of a truly diverse workforce, specifically when it comes to management-level job opportunities. How are you addressing this issue, and how do you measure progress?

TCE: Like many other financial regulatory agencies and across the financial industry as a whole, we are actively trying to understand and develop solutions for challenges we are experiencing in attracting and retaining diverse talent.

We first had to truly understand the issue through an analysis of the data. In collaboration with our human resources colleagues, we looked at CFTC-wide data, division-specific data and data trends across grades and occupational categories. We conducted an analysis of our pipeline into management-level job opportunities. We are also reviewing and analysing our applicant flow data across positions.

We learned we have some data gaps that impede a full understanding of the root causes of the challenge, and we have incomplete data or have not maintained baseline data in some of these areas. We are working collaboratively to assess progress and evaluate root causes, as well as build evidence on key questions regarding DEIA initiatives and integrate insights into policymaking and operations.

Even as we work to build that data strategy, we are consulting and advising on the implementation of structured, equitable hiring processes that mitigate potential bias and developing inclusive outreach and engagement strategies. We are also providing advice and consultation on advancing new internal leadership development and mentoring programmes for non-supervisory employees to help create a pipeline of promotion-eligible candidates.

In addition, we are seeking opportunities to expand paid internship and fellowship opportunities to support the development of a diverse talent pipeline to maximise the CFTC's ability to build a high-performing workforce from all segments of society. From a purely numbers perspective, we will look to measure progress in the diversity of our applicant pools and improvements in our DEIA index score in the annual Federal Employment Viewpoint Survey. I am proud to note that since my arrival in 2022, we saw an overall increase in the DEIA index and in every category of the index from 2022 to 2023 for the CFTC.

It is important to emphasise that we are embracing and promoting a growth mindset, so progress is measured not only through acknowledging and celebrating the accomplishment of goals, but through learning and improvement. We will continually engage in review and iteration of our strategies and activities, so we are embracing the idea of continual improvement on our DEIA journey at the CFTC.

IQ: The CFTC has committed to promoting DEIA at all levels of the workforce, and its talent and business operations. How do you define your objectives in each of these areas and what challenges do you encounter? →

"Like many other financial regulatory agencies and across the financial industry as a whole, we are actively trying to understand and develop solutions for challenges we are experiencing in attracting and retaining diverse talent"

→ **TCE:** Broadly, our objective is best articulated through the CFTC's DEIA vision statement: "The CFTC embraces diversity as a strength and understands that transparency, fairness and equity must guide decision-making. Everyone is accountable for contributing to a respectful, safe, inclusive, accessible and collaborative workplace culture so that opportunities and means to excel are available to all."

I hope during my time at the CFTC, I will have helped to usher in a culture where equity is both an intrinsic value and the normal course of business, an environment where open conversations about similarities and differences enable strong, sustainable organisational decisions, and a culture where inclusion and access are reflected in our everyday actions.

As the first chief diversity officer at the CFTC, I am working with our leaders and our workforce as a whole to embrace collaboration and innovation and demonstrate a willingness to try new approaches in ways that can mean rethinking how we do business, working across traditional silos and challenging long-held assumptions and processes. Change is hard and those conversations and expectations can be difficult. In our development of the CFTC's first DEIA strategic plan and the thoughtful engagement of our executive leadership team, I see progress and I am optimistic about what we are positioning ourselves to accomplish.

IQ: As a regulator, how do you interact with diversity programmes and initiatives being undertaken across the industry? Do you think more regulatory intervention is needed to ensure progress is made across the board?

TCE: I am regularly invited to speak at industry conferences and roundtables and participate in monthly inter-agency meetings with OMWI directors or chief diversity officers at other financial regulatory agencies. We partner with other financial regulatory agencies on initiatives, share best practices and provide advice and guidance to each other.

Section 342 of the Dodd-Frank Act established OMWI offices at financial regulatory agencies and provides broad statutory authority and protection for diversity and inclusion initiatives at financial regulatory agencies. As the only financial regulatory agency that was not included in the Dodd-Frank Act, the lack of this statutory authorisation impacts the CFTC's ability to fulfil the broader mandates of Section 342 to address diversity and inclusion within the CFTC's workforce, procurement and contracting activities and regulated entities.

I will continue to advocate for a legislative or regulatory fix that places the CFTC's ability to advance and promote DEIA on a par with other financial regulatory agencies and my agency's leadership has also advocated for this for years. We'll get there one day, hopefully soon.

DIVERSE AGENCY EXPERIENCE

Tanisha Cole Edmonds is the first chief diversity officer at the Commodity Futures Trading Commission (CFTC), where she is responsible for providing leadership and executive direction to the CFTC's efforts to integrate and promote diversity, equity, inclusion and accessibility at all levels of the agency's workforce, and its talent and business operations.

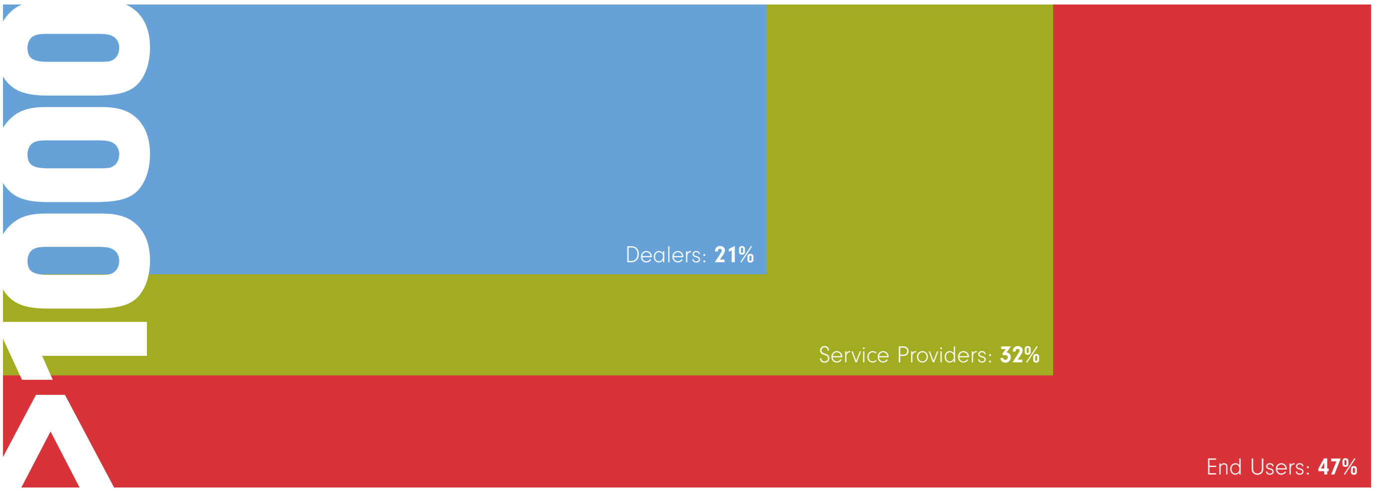
Prior to joining the CFTC in 2022, Edmonds served as deputy director for the Office of Diversity, Inclusion and Civil Rights and deputy chief diversity officer at the US Department of the Interior. She has more than 20 years of combined experience of labour and employment law litigation and implementing equal employment opportunity and diversity, equity and inclusion workplace strategies and solutions.

Edmonds began her career as an attorney at Passman & Kaplan PC, a boutique law firm in Washington, DC, where she litigated employment discrimination complaints before the Equal Employment Opportunity Commission, Merit Systems Protection Board, and the US District Court for the District of Columbia. Edmonds was also a contributing author of Passman & Kaplan's first edition of the Federal Employees Legal Survival Guide.

MEMBERSHIP INFORMATION

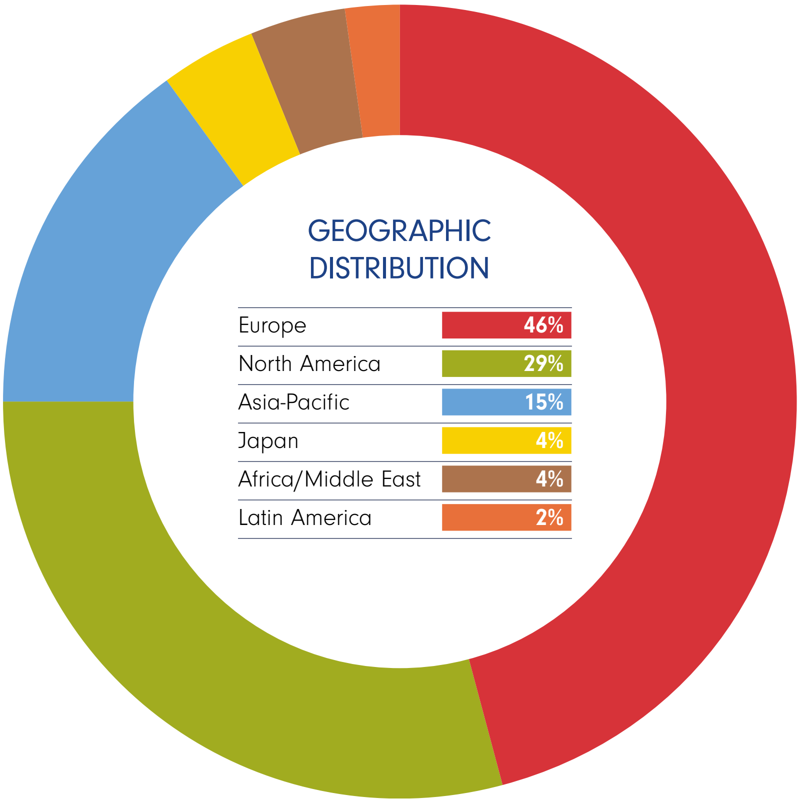
ISDA has over 1,000 members from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers.

MEMBERSHIP BREAKDOWN



TYPES OF MEMBERS

Banks	31%
Law Firms	21%
Asset Managers	9%
Government Entities	13%
Energy/Commodities Firms	7%
Diversified Financials	6%
Technology/Solutions Providers	4%
Other	9%



GEOGRAPHIC DISTRIBUTION

Europe	46%
North America	29%
Asia-Pacific	15%
Japan	4%
Africa/Middle East	4%
Latin America	2%

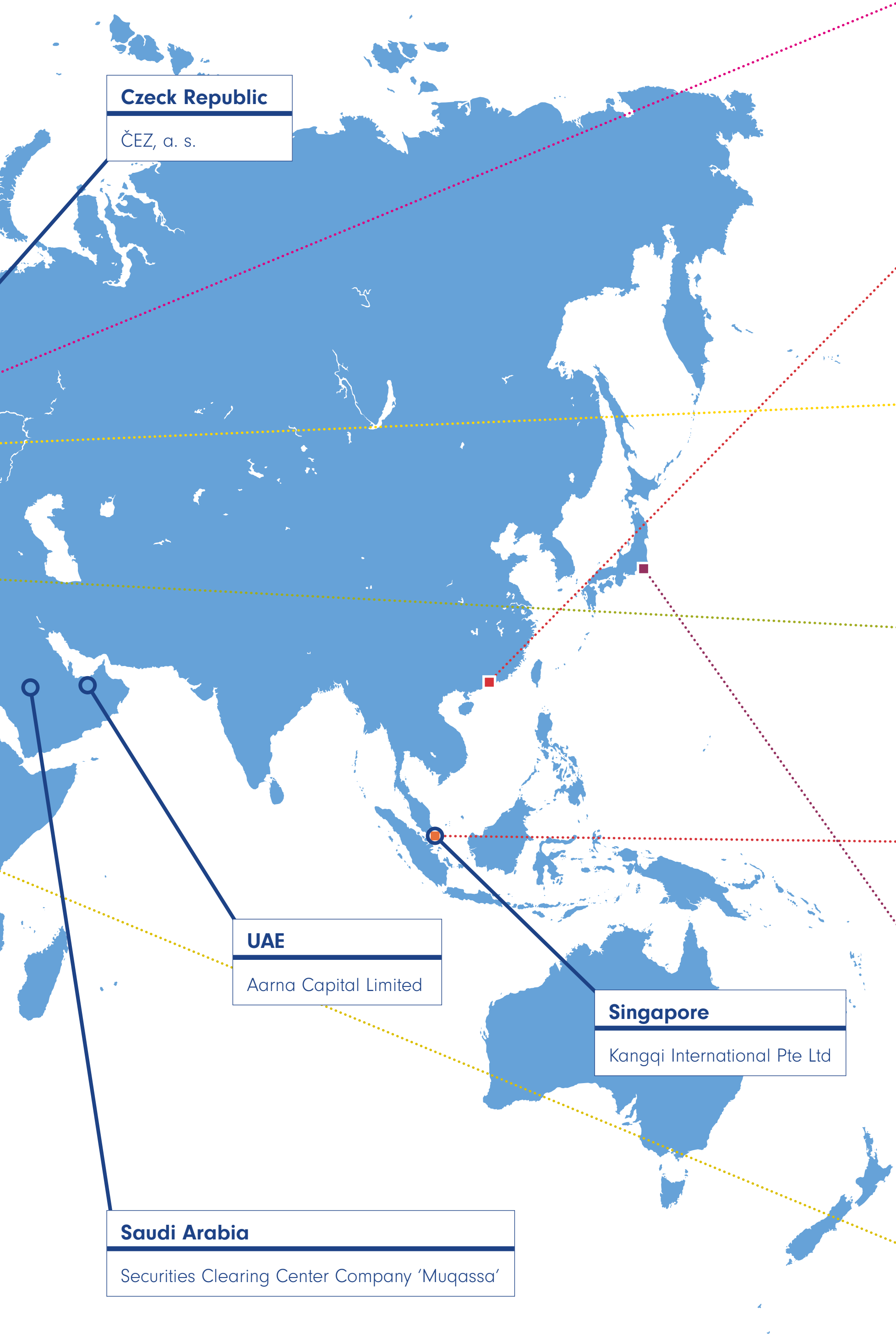
Additional information regarding ISDA's member types and benefits, as well as a complete ISDA membership list, is available on the ISDA Membership Portal: https://membership.isda.org/

NEW ISDA MEMBERS

A big welcome to all new members that have recently joined ISDA. We look forward to working with you in the future

For additional information on joining ISDA, please visit the ISDA Membership

OFFICE LOCATIONS



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"Our policy plan for promoting Japan as a leading asset management centre aims to achieve a virtuous cycle of growth and distribution, in which we will encourage Japan's household savings, which account for more than half of household financial assets in Japan, to shift into productive investment"

Shigeru Ariizumi, Financial Services Agency