Opening Remarks of Robert Pickel,
ISDA Executive Director and CEO,
At 23rd Annual General Meeting,
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Good morning. I'm delighted to welcome you back to the second day of our annual general meeting.

I hope you are all enjoying this event. Attendance is terrific, the support of our sponsors and exhibitors has been great. We are also grateful to all of our speakers for devoting their time to so many interesting sessions. I want to thank all the members of ISDA's incredibly capable and professional staff who have worked so hard to make this such a successful event.

Some of you may recall that this is our second annual meeting in Vienna. The first was held back in 1991…and while much has changed since that time, there are similarities worth noting.

First, back then, we were widely thought to be in the midst of a credit crunch. You'll remember that it was also an unhappy time in the real estate market; home values were dropping back then. Banks, particularly savings and loans in the U.S., had recently failed.

Operational strains were also showing as the interest rate swap business grew rapidly at the end of the 1980s and early 1990s, outpacing the ability of firms' existing infrastructures to adapt to the growth.

Back in 1991, we were also at the very beginning of a period of heightened scrutiny of our business. We may well be again…Jonathan Moulds mentioned this yesterday and I'll discuss it a little more today.

Also, let's not forget that we were on the cusp of an incredible expansion of the global economy that continues to this day – even if there was no way of knowing it then. It is no mere coincidence, I believe, that derivatives have also seen tremendous growth and innovation over that same time period.

As a result, today, more than ever, it is vitally important that we in the industry understand and articulate the key benefits of our business. There are several fundamental principles that we, as the industry association, believe about this business. And we all need to keep these in mind in our interactions with anyone who takes a keen interest in the future of this business.

Simply stated, privately negotiated derivatives deliver incredible value to the global economy. They are among the most innovative and most liquid products in the world.

They are powerful tools that enable companies to manage an ever-widening range of risk in their business and to assist firms in their execution of integrated strategies for investment and yield enhancement.

It's important to remember that OTC derivatives are distinct in important ways from other financial products. They are privately negotiated, bilateral contracts between counterparties. They are distinct from the cash instruments that they are often based on, even though their value may be derived from those instruments. They create opportunities that did not previously exist.

Because of the importance of these products, consideration of new regulation must proceed with caution. Otherwise, liquidity and innovation could be hampered. We believe that the industry is best positioned to develop responses, as it has done on numerous occasions in the past. In this regard, we note that the several recommendations in the Financial Stability Forum report released over the weekend that are specific to OTC derivatives pointedly leave it to market participants and the financial industry to address them.

Finally, legal certainty of the contracts, netting and collateral arrangements is critical to the proper functioning of OTC derivatives. This is so central to what we do as an organization on behalf of the industry that it bears repeating: the ISDA Master Agreement, close-out netting and collateral provide a solid foundation for the continued growth and innovation of this business. These protections are real, they are effective and they are tested. We do everything that we can possibly do to ensure that the importance of these protections is understood.

So we have been here before, yet while there are many similarities between 1991 and 2008, there are also many differences – and one of the biggest changes is the growth and evolution of credit derivatives. Whatever anyone may want to tell you now, I think it's fair to say that credit default swaps were not really on anyone's radar screen when we last met as an industry in Vienna.

Today, of course, credit derivatives are receiving a lot of attention, and I want to spend a few minutes discussing this.

Credit derivatives, particularly credit default swaps, have created a vibrant and extremely liquid marketplace for trading or offsetting credit risk, often outstripping volume in the underlying market, such as the corporate bond market. The dynamic marketplace for credit that has flowed from the introduction of credit derivatives has created opportunities that never before existed. Single names. Baskets. Indices. Structured Products. Going long – or short – credit synthetically. All of these developments have made for a better, deeper, more liquid – and more transparent – market for credit. Whatever our experiences of the past few months, and whatever noise we may hear to the contrary, we must not lose sight of this crucial fact.

As proof of the importance, the resiliency and the vibrancy of credit derivatives, one can look at how they have performed during recent market disruptions. Numerous times over the past few years, we have heard one pundit or another boldly assert that the credit derivatives market has not been tested, doubting their ability to perform in a credit crunch. Yet, here we are in the most serious credit crunch of the past 15 years, and these markets have continued to remain open, providing an outlet – in many cases the only outlet – for firms to continue to manage their credit risk. One thing about pundits: they never have to admit they were wrong.

As in all times of market stress, the bids and offers may be wider and volatility is greater, but it has been possible to get prices in virtually all sectors. These are signs of an active, vibrant market responding to the collective sentiments of market participants. Bearish views on credit and increased nervousness about credit generally were bound to be expressed through this liquid market. So it is no surprise that we have seen wider spreads and greater volatility. The repricing of credit, which most market observers believed was long overdue, is done most effectively through the most liquid market.

Clearly, ISDA has done a tremendous amount of work to ensure the prudent and efficient development of this business. ISDA's protocol and auction mechanisms, for example, have been successfully used for nine credit events. Many of you in this room have played an important part in this effort, and your work is very much appreciated.

We are moving forward with incorporation of these mechanisms into the credit derivative definitions. We are aware of the keen interest of regulators in seeing this done, and it has always been our intention to do so, using the collective experience the market gains from use of the auction in real life situations.

But all of you should know that this mechanism is live and ready to use again in case of a credit event – large or small and wherever it may occur. We can implement the protocol process quickly, and our partners at Creditex and Markit have a well-established process for executing the auction. The knowledge that we have a working mechanism ready to go allows us to concentrate our ongoing efforts on incorporating – or "hardwiring" – the mechanism into the documentation.

While credit derivatives have indeed functioned well, two issues seem to be the principal focus of global supervisors: transparency and the operational infrastructure.

There are two senses in which transparency is relevant. First, there is a desire to understand the extent of exposure within individual firms and in the system as a whole. Second, there is a need to have information available to allow parties to value these positions, recognizing that the value of some of these positions may ultimately be a function of models driven by market inputs and not direct market values.

Transparency, as it relates to individual firm exposure and valuations, is best dealt with through disclosure, such as is required by existing accounting requirements, and supervisory review of positions and practices, pursuant to existing authority. Firms have this information, and they use their risk management systems to determine their exposure. Market information is available, but to the extent there is a need for more or different types of information, I am confident that the many information providers will work to satisfy that demand.

Transparency, as it relates to exposure to the system must be properly understood. We believe it's important to ensure a balanced perspective on the exposure counterparties take on through credit derivatives and, in turn, that collective exposure to the system. As you have heard, the credit derivatives market continues to be the fastest-growing segment of the business, growing 82% year-over-year to $62 trillion in notional as of year-end 2007.

However, it's important to remember what that $62 trillion number represents. Jonathan spoke yesterday about this and it's worth repeating. It's the notional amount of all outstanding credit default swap contracts. It represents $1 trillion of net protection sold by protection sellers in underlying risks. Assuming conservative estimates of default and recovery rates, we estimate that protection sellers face aggregate losses of $15 billion over the life of the contracts.

This represents an estimate of the possible net payments in settlement of aggregate risk shifted through the credit default swap mechanism. Separate, but equally important, is the counterparty risk that is created by the existence of a derivative trade – whether it is a credit derivative or not. Anyone who enters into an OTC derivative trade is taking on some element of counterparty risk. It is precisely because of this risk that ISDA has worked on behalf of the industry for 23 years to establish a robust legal framework for derivatives. Our efforts on the master agreement, close-out netting and collateral provide the fundamental protections that enable derivatives to thrive.

Operational issues continue to be squarely on the radar, and we continue to devote a significant level of resources against this. We had two sessions yesterday on operational issues alone. They are issues that cut across asset classes, although credit derivatives have been a particular focus, given that they have grown so fast in recent years. These issues will be resolved by the market – as the regulators expect – and we plan to play a central role in ensuring that all perspectives are heard.

No doubt one of the issues we will be facing over the next year or so is whether our business requires more regulation. We have heard speculation from some industry commentators and in the media about the need for, even the inevitability of, more regulation of derivatives in light of recent market volatility. Interestingly enough, the regulators themselves have not been part of the vocal crowd clamoring for more regulation.

We believe that regulators recognize that the best way for risks to the system to be effectively controlled is through market intermediaries actively monitoring relationships with their counterparties. We have heard this statement, in various forms, in private conversations and in public statements.

Counterparty risk management protects individual counterparties, and the system as a whole becomes stronger. In other words, focusing on risk management at the micro, counterparty level enhances stability at the macro, systemic level.

ISDA completely supports the continued strengthening of counterparty risk management…it is, after all, precisely why the Association was founded in 1985. It's the impetus behind the development of the ISDA Master Agreement, close-out netting and collateral management. It underpins our work on regulatory capital issues.

It's worth noting that supervisors are sensitive to ensuring that their regulatory footprint does not stifle innovation and market discipline in our business. For example, in a report published this past weekend, the Financial Stability Forum said: "Authorities should not preempt or hinder market-driven adjustments, but should monitor them and add discipline where needed."

We know all too well the law of unintended consequences of regulatory action enacted hastily in response to a real or perceived crisis. Two names. Sarbanes. Oxley. We fully understand that the current financial turmoil is the most serious financial market situation of the past two decades. A serious situation requires serious, carefully considered analysis of root causes and a calibrated response to those causes. This Vienna AGM is a significant effort by this industry to better understand those root causes, and our first panel this afternoon will explore the crisis.

As a result of the increased regulatory scrutiny in the face of recent financial markets volatility, ISDA will be very active on global public policy issues in Europe, the US and Asia. It's an inherent part of our mission: to encourage the prudent and efficient development of global privately negotiated derivatives activity, and to identify and reduce the sources of risk in our business. Furthermore, it is incumbent upon us, as an organization, and for each of you, as our members, to raise awareness of the positive role that derivatives play in the global financial system.

From risk management to documentation, from operations to accounting, from public policy to collateral management, ISDA remains active on many fronts. In risk management, the increased focus on capital levels of financial institutions will require us to engage at the Basel Committee and at the national supervisor level. The consideration of capital levels must consider the safety and soundness of the system while continuing to foster innovation and appropriate levels of risk taking.

When people focus on our documentation efforts, they often start and end with our efforts in the credit derivatives space. But, as always, there is much, much more. Energy efforts continue to expand. Equity demands greater standardization. Interest rates and currencies, though mature, require regular attention. New areas – property, longevity, emissions – are always appearing. Our last session of the day will give you a feel for the scope of our documentation initiatives.

Our technology initiatives, particularly FpML, will increasingly be the foundation for the goal of interoperability that is so critical to achieve if we are to deliver on a comprehensive operational strategy for the business. The user group that we commenced a year and a half ago with SWIFT is beginning to bear fruit.

In collateral, we are looking at the lessons to be learned from the functioning of collateral management in the recent volatility. Accounting – particularly the three levels of FAS 157 and the notion of "fair value" – seems to be an area of continuous scrutiny and change, and it is an area that we must continue to influence.

To ensure the continuing growth and success of our industry – and our Association – ISDA implemented a Strategic Plan to guide our efforts in the years ahead. We now have a network of seven offices in key global financial centers. We have added new senior staff in Europe and Asia and are committed to providing an even greater level of service for our expanding membership.

We do believe we are unique:

- unique in the scope of our membership, both geographically and institutionally
- unique in the international coverage of the organization and the multifaceted backgrounds and skills of our staff and
- unique in the range of underlying risk that we address in our documentation and in our other initiatives.

Derivatives are without a doubt the most powerful and liquid instrument available to help market participants take on or divest risk as best suits their appetite and tolerance for risk.

While the past year will be remembered as a year of significant volatility in the global financial markets, those of us in the privately negotiated derivatives industry will also remember it as one in which our business continued to function efficiently and effectively.

Let me close by going back to ISDA's key messages, and here I am tempted to say, "repeat after me"

Derivatives deliver incredible value to the global economy.

Derivatives create new opportunities for risk management and investment.

OTC derivatives are distinct in important ways from other products and all constituencies need to recognize these distinctions.

Considerations of regulation must proceed with caution. Otherwise liquidity and innovation could be hampered.

Legal certainty of the contracts, netting and collateral arrangements is critical to the proper functioning of derivatives

I have no doubt that these will continue to be our messages 17 years from now.

ISDA will continue to work hard to ensure that we effectively communicate these messages on behalf of our industry. We look forward to working with each of you to deliver these messages around the world.

Thank you all for your continued support.