ISDA. Safe, Efficient Markets

Financial Services Strategy
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Response to HMT Call for Evidence – Financial Services Growth & Competitiveness Strategy

The International Swaps and Derivatives Association, Inc. (ISDA)[1] welcomes the opportunity to respond to the government's Call for Evidence on FS Growth & Competitiveness Strategy.

The UK is the largest global centre for OTC derivatives trading and English law is the dominant legal standard in the derivatives market across the world. ISDA has been working to make the global derivatives markets safer and more efficient for almost 40 years and we represent over 1,000 members worldwide. To answer some of your stakeholder questions in Chapter 6, we are an international trade body, operating out of our London offices to answer this call for evidence. We are headquartered in New York and (in terms of employees) we are approximately a medium sized organisation in both the UK and US (according to your parameters). We also have offices in Brussels, Singapore, Hong Kong, Tokyo and Washington D.C.

Overview and summary

We welcome the opportunity to respond to this Call for Evidence and have chosen to focus on answering certain questions around innovation and technology, international partnerships and trade and sustainable finance.

Overall, it is important that the UK continues to evolve its derivatives regulatory framework to reflect market developments and ensure the UK remains competitive. To this end, ISDA has a range of specific recommendations for EMIR[2], and we would welcome the government prioritising these in 2025 through the Smarter Regulatory Framework. We note that the EU has recently completed its own review of the European Markets Infrastructure Regulation (EMIR 3.0) introducing a number of important changes that will benefit EU market participants, and

[1] **About ISDA**

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions 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. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on LinkedIn, Facebook and YouTube.

[2] Response-to-HMT-FCA-and-PRA-on-UK-EMIR.pdf

the UK has an opportunity to ensure it continues to adapt the regime to fit the needs of UK markets.

It is also very important for the UK to retain its reputation as a world-leading host for CCPs, with a robust regulatory framework – e.g. as recently evolved through the Bank of England's System-wide exploratory scenario, its proportionate recognition regime, its CCP Recovery and Resolution Regime, and the new FMI principles. This is working well, and the UK needs to keep its focus on this area. The UK should look at financial stability both in rulemaking and resolution of FMIs not only in the UK, but also globally, given that the UK hosts two global CCPs. As the time-limited EU equivalence decision for UK CCPs expires on 30 June 2025, it is critical that the UK government engage with the European Commission in the UK's request to extend the equivalence decision for UK CCPs in a non-time-limited manner and well in advance of 31 March 2025.

Innovation & Technology

Q4.4) What is your assessment of how effectively the UK supports innovation and the adoption of new technology? What could be improved in the financial services sector?

There are many ways in which the government should support innovation across the financial services industry, with many worthy initiatives across the sector. Specifically for derivatives, the UK has the potential to become the leading financial centre globally in leveraging technology to standardise how financial products are represented and managed and digitise the OTC derivatives post-trade lifecycle.

The UK is the largest global centre for OTC derivatives trading and therefore it can and it should take a leading role in innovation and technology. Currently, derivatives market participants continue to rely too heavily on paper documents, manual processes, and non-standard practices. Digitisation will create a more attractive investment environment for internationally active firms seeking more efficient and cost-effective solutions to regulatory compliance. It will also reap major improvements in managing risks across financial markets, with policymakers looking to strengthen their ability to monitor the risks faced by counterparties from their derivatives transactions following recent market turbulence, such as the LDI event.

To support innovation in the derivatives industry, the government can play a vital role by:

1. **Championing a common, open-source data standard for financial products** by which we can build automated solutions that are consistent across multiple products, business lines, and regulatory regimes. This could be built off the success of the Common Domain Model[3](CDM), developed by ISDA, ICMA and ISLA and now under the governance of the Fintech Open Source Foundation (FINOS), which provides the foundation for initiatives to digitise regulatory reporting, key collateral management processes, and other post-trade lifecycle processes.

[3] https://www.finos.org/common-domain-model

The Transforming Data Collection (TDC)[4] program being run by the Bank of England and FCA is an example where the UK is already looking to improve the accuracy of data reported to regulators, whilst simultaneously introducing greater efficiencies to the reporting processes, and reducing the burden on market participants. The TDC itself cites “Defining and adopting common data standards” as central to achieving its vision. Furthermore, one of he intended outcomes of the TDC is establishing machine executable regulations which will dramatically improve the standard of reporting in the UK, potentially setting it apart from other global jurisdictions. The goals of the TDC also opens up greater possibilities for blockchain and AI to further the quality of data reported to regulators and reduce the impact of adhering to reporting regimes on firms. Foundational to all such initiatives though is a common data standard adopted by regulators and the industry, that can be applied consistently across financial products and processes.

In order to support the TDC program, set the UK on a path to being a global leader for machine executable regulations, and realise the potential benefits of blockchain and AI, it is essential that a single, common data standard is adopted and used consistently across regulatory regimes and across financial products. The CDM, as an existing open-source model, would be a prime candidate for this purpose which continues to be developed and expanded, and can be applied immediately.

2. **Supporting the development of robust legal foundations for emerging technologies, such as smart contracts and digital/tokenised assets.** The Property (Digital Assets etc) Bill is an important step in modernising English property law by confirming that digital assets can be objects of personal property rights. The Bill provides a solid foundation for further development of nuanced legal principles to evolve over time, reflecting the novel characteristics of digital assets and their applications. ISDA has undertaken several initiatives to provide guidance on these issues, by producing contractual standards for trading digital assets and a series of whitepapers on the application of English insolvency law to digital assets.

3. **Providing leadership** for timely investment in machine-readable and machine-executable regulation. Authorities must be clear regarding specific standards, after full consultation with the market, to ensure timely and broad adoption.

The benefits for UK policymakers in getting this done are simple. Digitisation will create a more attractive investment environment for internationally active firms seeking more efficient and cost-effective solutions to regulatory compliance. There will be enhanced reliability from regulators that when data is provided to them by market participants, it will be complete, accurate and standardised. It will also reap major improvements in managing risks across financial markets.

International Partnerships & Trade

Q4.12) What barriers do international financial services firms face in either establishing and operating in the UK, or using UK markets?

[4] https://transformingdatacollection.co.uk/

In general, the UK has a flexible regime for cross-border business, so international financial services firms do not face significant barriers in operating in the UK or in using UK markets. The main exception is in relation to business with retail clients / consumers, where there are policy reasons for the majority of barriers to cross-border business.

However, there are a number of areas where regulation has resulted in challenges to cross-border business or to establishment in the UK. In particular:

- Equivalence-based regimes: the UK has not traditionally relied on equivalence-based approaches to cross-border business, so this is a more recent development and arises in particular with onshored EU legislation. The starting assumption for equivalence-based regimes is typically that other jurisdictions will introduce equivalent regulation. However, even where there is international consensus on the need for new regulation (such as in the case of the post-crisis OTC derivative reforms) not all jurisdictions introduced regulation that was considered to be equivalent to the EU OTC derivatives reforms. For example, in some cases the scope of the relevant regulation was considered to be too different for equivalence (e.g., in relation to the definition of "OTC derivative", the available exemptions or the scope of obligations). This creates challenges for UK firms dealing with non-UK firms even in G20 jurisdictions that may have introduced comparable regulation, as well as emerging markets jurisdictions which are unlikely to have introduced similar regulation. We would welcome a review of equivalence-based regimes to confirm whether they remain necessary, proportionate and sufficiently flexible to fulfil a specific policy objective. Any retained equivalence mechanisms should be refined to ensure they remain fit for purpose, by reviewing the basis on which equivalence would be granted to ensure there are no technical limitations to the UK adopting an outcomes-based decision. Where equivalence is no longer required as a mechanism, it should be removed and as necessary replaced, for instance with guidance enabling firms to determine whether or not a non-UK regime is considered to be equivalent. A review of equivalence regimes should start with those for which temporary transitional treatment has been necessary to avoid disruption arising from the absence of UK equivalence decisions, as under EMIR and the Benchmarks Regulation. Reform can be enacted as legislation is passed through the UK's new Smarter Regulatory Framework.
- A similar issue arises where obligations only apply to non-UK entities if they would have applied if the entity had been established in the UK. This creates challenges with determining how an entity subject to a foreign regime would have been treated if it had been a UK entity. We ask that the UK considers applying a regime of deference and/or proportionality to non-UK banks who are already subject to a similar, detailed regulatory regime in a particular area, especially where their UK branch is caught by both UK and non-UK rules in this area (and by non-UK Head Office policies/procedures based on similar non-UK rules).
- Consistency of regulation: one point that is key to international financial services firms is consistent application of any exemptions or cross-border regimes that they rely on to do business in the UK. For example, a number of non-EU CCPs had their recognition automatically withdrawn when their home jurisdiction was included on the FATF grey list. While in some cases the relevant jurisdiction was removed from the list shortly afterwards, those CCPs will not seek EU recognition again because of the significant cost involved in obtaining recognition and the potential for it to be withdrawn without notice and with no compensation. We welcome and strongly support the steps that the UK has taken to avoid similar issues arising with respect to CCPs currently recognised

in the UK and raise this only as a recent example of the negative consequences of cross-border regimes that can be withdrawn on short notice. The UK should ensure that its approach to regulating non-UK firms provides for a stable platform and certainty for those non-UK firms of the circumstances in which their ability to deal with UK clients may be withdrawn.

- Challenges in tracking UK regulation post Brexit: the ability to track relevant provisions of UK regulation (including application of temporary exemptions and changes in scope of application) has also proved to be something of a barrier to cross-border business for international financial services firms. While we appreciate that the UK authorities are working hard to repeal and replace onshored EU legislation, and that this is a process that needs to be carried out carefully and thoroughly, the longer it goes on the more uncertainty it creates. As onshored EU law has been subject to successive layers of amendments by Statutory Instruments in recent years, the accessibility of UK financial services legislation now lags behind the EU, which makes available consolidated versions of primary legislation within which changes can be seen in line. Further, progressing changes through the UK's Smarter Regulatory Framework requires close ongoing cooperation between HMT and the regulators. Each policymaker has their own approaches for publishing updates, whether via Statutory Instrument or Policy Statement, through their own channels. It can be difficult for market participants to identify how related changes that represent a coordinated approach from government and regulators tie together, for instance where primary legislation is replaced by regulatory rules, adding to the cost for firms in remaining up to date, and compliant with the UK regime. We understand the longer term aim of the SRF is that more detailed technical firm-facing rules will in future generally sit within the regulators' rulebook, and as such this is a "temporary" issue, but as completion of the SRF is expected to take many years, in the meantime we urge HMT and regulators to issue clear coordinated communications wherever possible to signal to market participants how to read across between Statutory Instruments and regulatory rulemakings.

Q4.13) What opportunities should the government seek to advance through its international financial services relationships?

ISDA commends your commitment to rebuilding relationships with Europe. Rebuilding ties with Europe will enable the UK to benefit from a number of opportunities, including reinforcing and growing the existing strong connections between UK and EU markets. To highlight just one example, how accelerated settlement and the move to T+1 is adopted in the UK, EU and Switzerland will have a large bearing on the competitiveness and attractiveness of the respective markets, and a coordinated approach ought to be beneficial to all parties.

While we consider Europe to be a priority jurisdiction, there are also significant opportunities to grow the financial services relationship with other jurisdictions, building on recent trade deals or international agreements. We note that HMT is already undertaking a review of the opportunities that exist for provision of cross-border financial services between the UK and China, and between the UK and Saudi Arabia, and we would be happy to discuss these opportunities further with respect to derivatives activity. We also welcome development of the Mutual Recognition Agreement between the UK and Switzerland and would encourage HMT to explore other jurisdictions where a similar arrangement might be possible.

Strengthening these relationships and facilitating stronger ties between regulators will support opportunities for UK firms to carry on business in other jurisdictions as well as for non-UK firms to offer services to UK clients. While building these relationships may not lead directly to lifting of barriers to cross-border business, increased governmental and regulatory dialogue is always helpful both in understanding where the existing barriers lie and how they could potentially be smoothed, but also in avoiding creation of new barriers. For example, both China and Saudi Arabia have recently taken steps to ensure that close-out netting is enforceable in their jurisdictions, but it is always helpful to keep dialogue open on these issues. We have seen changes in law in other jurisdictions (e.g., the introduction of resolution measures for new types of regulated entities, or changes to insolvency law more generally) have a negative impact on key issues such as netting and collateral enforceability and settlement finality, and discussions with other regulators can often help to resolve these types of issues.

Sustainable Finance

Q5.5) In the UK's sustainable finance framework, as set out in the Chancellor's Mansion House package, do you see barriers or gaps that would support the growth and competitiveness of the UK's sustainable finance market?

The UK is well positioned to become the global leader in the trading of voluntary carbon credits. Speed is of the essence. The race to become the global hub for voluntary carbon credits is a competitive one. The UK needs to show agility and purpose if it is to seize the opportunities ahead.

The long-awaited consultation on Voluntary Carbon and Nature Markets is expected to address the development of the legal, tax and accounting treatment of voluntary carbon credits under UK rules, as well as to clarify how financial market infrastructure in the UK will handle environmental transactions such as carbon. We welcome the publication of this consultation so that matters are progressed. We are supportive of the UK's government efforts to develop voluntary carbon markets, building on ISDA's five recommendations on scaling carbon markets.

The government can play a vital role by:

- Clarifying how financial market infrastructure in the UK can facilitate the scaling of carbon credit transactions, including supporting the development of new products and services (e.g., clearing, settlement).
- Communicating the benefits of a high-integrity voluntary carbon market in helping the UK to reach its net-zero target, aligned with global efforts to mitigate the threat of greenwashing.
- Helping to drive decisions relating to the legal characterization of environmental products across all jurisdictions, which the UK can do by leveraging its membership of relevant intergovernmental organisations.

Q5.6) What do you think should be the UK's priority when engaging with the global sustainable finance agenda, both bilaterally and at a multilateral level?

Given the global nature of the sustainable finance market, the UK's priority should be to ensure as much interoperability as possible across jurisdictions of any standards relating to ESG. Working together with our global counterparts should result in consistent and coherent

regulatory standards. Picking out any one priority within this is hard, but we recommend, as a starting point, both linking the UK and the EU emissions trading schemes (ETS) and building an internationally consistent and interoperable framework for the scaling up of Voluntary Carbon and Nature Markets.

Linking the EU and UK ETS would enhance the integrity and confidence in both regions' carbon markets and lower the cost of decarbonising both economies as they pursue net-zero policies. Crucially, the move could spur other countries to adopt similar carbon pricing mechanisms. Linkage would also enhance liquidity and price discovery and establish a level-playing field in carbon pricing, incentivising investment sectors and ensuring that no new trade barriers on carbon leakage are created between the UK and the EU. We have actively advocated for the linkage between the UK ETS and the EU ETS. In a private letter co-signed by 45 other organisations, we urged the UK Government to prioritise this linkage. To reinforce our position, we have circulated the letter at the highest levels of the European Commission.

Time is of the essence, however: should the schemes continue to evolve in isolation, finding a linkage arrangement will inevitably become more challenging. It is important for the UK to engage constructively on this issue as soon as possible.

ISDA believes that a robust voluntary carbon market plays an important role in delivering a reliable, market-based approach for investment opportunities that reduce greenhouse gas emissions and remove carbon from our atmosphere. We have a strong interest in the development of a robust voluntary carbon market that will strengthen the functioning of the carbon credit derivatives markets and enable the continued development of liquidity in derivatives products so that market participants can appropriately manage their business risks. Facilitating trading in carbon credit derivatives that serve as a hedge for climate mitigation projects will contribute to the development of deep and liquid voluntary carbon credit markets.

It will be important that the upcoming consultation on Voluntary Carbon and Nature Markets looks at promoting trading of credits across borders and does not promote requirements for local credits only in UK market. The consultation should enhance the legal, regulatory and accounting framework around these markets.

Q5.7) What are the opportunities and barriers for the financial services sector in developing the products and/or services necessary to facilitate investment into the net zero transition?

The further development of carbon markets will be integral to meeting the UK's net zero emissions target by 2050. This will require both scaling up voluntary carbon markets, where companies can buy verified carbon credits to reduce/avoid their net emissions and maximising the reach and impact of the UK's Emissions Trading System, where companies pay a price to pollute.

We should be mindful of the future policy measures that will affect the pricing of carbon. The EU Carbon Border Adjustment Mechanism is due to take effect in 2026, introducing a levy for carbon emitted during the production of certain goods imported into the region. The UK carbon border tax is due to be introduced in the UK in 2027. Given the transformational change that these carbon taxes will bring about, it is essential to eliminate any potential risk of trade diversion or other disruptive outcomes that might result from this timing misalignment.

Thank you for the opportunity to comment and we remain at your disposal for further engagement.

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