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Licensing the Gatekeeper? Public Pathways, Social Significance and the ISDA Credit Derivatives Determinations Committees[*]

John Biggins[**] and Colin Scott[***]

Abstract

Regulatory relationships in financial markets exemplify the importance and changing nature of transnational business governance interactions (TBGI). These interactions involve reciprocal forces of influence between private and public regulators. We examine one key case of private governance in financial markets: the emergence, structures and decision-making of Credit Derivatives Determinations Committees (DCs) of the International Swaps and Derivatives Association (ISDA). We highlight the mechanisms or 'pathways' of interaction between ISDA, governments, courts and public regulators. We demonstrate how interactions between state and non-state actors can occur in both operational and policy spheres. We find ISDA to be a particularly resilient private regulator in an environment subject both to the significant external shock of the Global Financial Crisis and intense pressure on governmental actors to demonstrate that they are counteracting risk. We consider the sources of ISDA's adaptive capacities. It is clear that ISDA operates as a key gatekeeper in the field and, significantly, the organisation appears to have a form of 'regulatory licensing' power in the DCs. This power of regulatory licence is derived in an immediate sense from the propagation of a web of contracts and norms established by market actors, the content of which is substantially derived from instruments such as the Master Agreement, set down by ISDA itself. But, equally importantly, we find that this regulatory licensing capacity is ultimately backstopped by an implicit delegation from public actors, which lends additional legitimacy to the DCs.

Keywords: Derivatives, Private Governance, Regulatory Reform

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I. Introduction

At the height of the events which have been subsequently labelled the Global Financial Crisis (GFC), the then French President, Nicolas Sarkozy, declared:

> Self-regulation as a way of solving all problems is finished. Laissez-faire is finished. The all-powerful market that always knows best is finished….[1]

Anyone listening to those remarks might have expected that important functions in maintaining the credibility and stability of financial markets, exercised by private regulators and found wanting in the GFC, would be taken on by public regulatory bodies. In fact, private and self-regulation have remained central to the regulation of financial markets, adapting to the challenges revealed by the GFC, and becoming subject to new forms of monitoring and oversight from public bodies; often in a form referred to as transnational business governance interactions (TBGI).[2]

In this article we explore a key example of TBGI in the financial markets; with a focus on the interface (or 'pathways of interaction')[3] between regulatory reform initiatives in the credit default swap (CDS) markets and the Credit Derivatives Determinations Committees (DCs) of the International Swaps and Derivatives Association (ISDA). The ISDA DCs have been endowed with the systemically important responsibility of determining whether 'credit events' have occurred under standardised definitions drafted by ISDA; thereby triggering payouts under CDS contracts.

Although relatively young, the role afforded the ISDA DCs means that they now occupy a key position in economically and politically high stakes market events, especially events involving sovereign debt or other sovereign implications. For example, this was evident recently when the DC for the Americas determined that a CDS triggering event had occurred as a result of a standoff between Argentina and 'holdout' creditors;[4] a dispute traceable to Argentina's debt restructuring exercises over a decade ago and which predated the establishment of the ISDA DCs.[5]

Accordingly, the ISDA DCs have, counter-intuitively some might argue, assumed a central position in financial markets since the outbreak of the GFC in 2008, notwithstanding their private regulatory pedigree. The ISDA DCs have also, to date, apparently not attracted the level of public regulatory scrutiny directed at certain other private ordering arrangements, such as the interbank rate-setting panels;[6] including a rate-setting panel presided over by ISDA.[7] This is despite some peculiar features

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[1] E. Vucheva, '"Laissez-faire" Capitalism is Finished, Says France', *EUObserver* (26 September 2008): available at http://euobserver.com/political/26814

[2] B. Eberlein et al., 'Transnational Business Governance Interactions: Conceptualization and Framework for Analysis' (2014) 8 *Regulation & Governance* 1.

[3] Ibid.

[4] ISDA, *Credit Event: Argentine Republic*: available at http://dc.isda.org/cds/argentine-republic/; See also, e.g., K. Burne and L. Josephs, 'Argentina's Default Sends Ripples Through Markets', *The Wall Street Journal* (1 August 2014): available at http://online.wsj.com/articles/argentine-bond-prices-fall-ahead-of-court-hearing-1406903633

[5] See, e.g., A. Gelpern, *After Argentina* (Institute for International Economic Policy Brief No. PB05-02, 2005): available at http://www.iie.com/publications/pb/pb05-2.pdf.

[6] Financial Stability Board, *Review of the Implementation of IOSCO's Principles for Financial Benchmarks by Administrators of Euribor, Libor and Tibor* (22 July 2014): available at http://www.financialstabilityboard.org/publications/r_140722a.htm

of the DCs which, in principle, raise conflict of interest concerns. While these concerns are not insignificant, in this paper we focus on understanding why the DCs have, despite these concerns, managed to successfully buck the trend of direct public regulatory interference following the GFC in relation to this sensitive function in the financial markets.

In seeking to acquire a more complete picture as to how this situation arose and is being maintained at time of writing, we assess ISDA through the prism of 'gatekeeper' theory.[8] We argue that ISDA's 'reputational capital'[9] and sheer dominance in the OTC derivatives market, while important, seem insufficient of themselves to entirely explain the establishment of the DCs and their ongoing viability. In search of a fuller explanation, we explore whether the contractually-based mandate assumed by the ISDA DCs, with at least the tacit support of public actors, can be considered to fit comfortably within the concept of 'regulatory licences', propounded by Frank Partnoy to explain the historic dominance of certain credit rating agencies under the legislatively embedded National Recognized Statistical Rating Organization (NRSRO) regime in the United States (US).[10]

We find that the establishment and continued existence of the ISDA DCs may be understandable from the regulatory licensing perspective and that this licensing function is also likely to become embedded within the reformed market infrastructure for OTC derivatives markets. However, we detect subtle, but potentially important, divergences with respect to the legal and normative basis for this regulatory licensing power in comparison to the US NRSRO regime, attributable to the idiosyncratic manner in which the ISDA DCs came into existence and maintain their legitimacy.

We thus conclude that if the ISDA DCs are to be deemed capable of issuing regulatory licences, the political and legal authority for this seems more subliminal; relative to the comparatively more explicit legal authority enjoyed by credit rating agencies historically operating under the US NRSRO regime. We suggest that the regulatory licensing capacity of ISDA derives as much from the contractual nexus underlying its establishment and operations as from a formal delegation of public power. Nevertheless, we consider that the DCs are ultimately backstopped by at least implicit public support, lending the DCs additional legitimacy and representing a key example of TBGI.

In terms of structure, this article first examines the context of the CDS markets, the role of ISDA as gatekeeper and how the GFC affected its activities and perceptions of it. Following this we examine the establishment and constitution of the ISDA DCs, as well as their potentially 'socially significant' economic and political role. We then highlight why the ISDA DCs may be understood to exercise a form of regulatory licensing power, albeit of a somewhat different character (in both its sources and operations) than is true of other well documented examples such as credit rating agencies. We

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[7] H. Jones, 'Swaps Trade Body to Reform ISDAFix from 2014', *Reuters* (19 September 2013): available at http://www.reuters.com/article/2013/09/19/derivatives-benchmark-reform-idUSL5N0HF1P120130919

[8] For a seminal exposition of gatekeeper theory see J. Coffee, *Gatekeepers:The Professions and Corporate Governance* (Oxford and New York: Oxford University Press, 2006).

[9] J.C. Coffee, 'The Role and Impact of Credit Rating Agencies on the Subprime Credit Markets', *Testimony Before the US Senate Banking Committee* (26 September 2007): available at http://www.banking.senate.gov/public/index.cfm?Fuseaction=Hearings.Hearing&Hearing_ID=973eab2d-f498-412b-86f3-ae6a4b147f03

[10] See, e.g., F. Partnoy, 'The Siskel and Ebert of Financial Markets: Two Thumbs Down for the Credit Rating Agencies' (1999) 77 *Washington University Law Quarterly* 619.

conclude with an assessment of the implications for the ordering of financial markets of these observations.

II. Context: CDSs, ISDA and the GFC

Amongst the things learnt during the GFC was the vulnerability of the international financial system to risks generated by, in particular, speculative trading in the sizeable derivatives markets. Derivative instruments have been defined as agreements between two counterparties where:

> the payoffs to and from each counterparty depend on the outcome of one or more extrinsic, future, uncertain events or metrics – that is, they are "aleatory contracts" – and in which one counterparty expects such outcome to be opposite to that expected by the other counterparty.[11]

Derivatives proliferate in form but share at least one commonality in that they embody a value which is intrinsically linked or contingent upon some external item of worth; hence they 'derive' their value from something else, referred to as the 'underlying'.[12] Depending on the type of derivative, the underlying can be a broad range of instruments. These include stocks, bonds, currencies, interest rates, energy, commodities, the weather,[13] and mortality rates,[14] for example.

Of particular interest for the purposes of this article are derivatives which are contingent on third party or instrument credit quality,[15] specifically credit default swaps (CDS). Put simply, in a CDS a 'protection buyer' makes periodic payments ('premium') to a 'protection seller' who undertakes to compensate the protection buyer in the event of a relevant 'credit event' (e.g. bankruptcy, restructuring) occurring in relation to the underlying reference entity or obligation. A reference entity can be a single corporation or sovereign ('single-name CDS') or a portfolio of reference entities. Reference obligations can include bonds, loans or other instruments.[16] As well as offering the possibility to hedge credit exposure to an underlying reference entity, CDS positions can also effectively act as proxies for adopting speculative positions on relative price movements in underlying reference bonds.[17]

CDSs are of relatively recent vintage. But other derivatives have been deployed throughout history[18] and from at least the 15th century certain of them have been traded on organised 'exchanges'.[19] Exchanges are central venues which facilitate transactions in relatively standardised derivative

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[11] T.E. Lynch, 'Derivatives: A Twenty First Century Understanding' (2011) 43 *Loyola University Chicago Law Journal* 1, at 14.
[12] See generally N.M. Feder, 'Deconstructing Over-the-Counter Derivatives' (2002) 3 *Columbia Business Law Review* 677.
[13] See, e.g., S. Randalls, 'Weather Profits: Weather Derivatives and the Commercialisation of Meteorology' (2010) 40 *Social Studies of Science* 705.
[14] See, e.g., J.K. Hance, 'Derivatives at Bankruptcy: Lifesaving Knowledge for the Small Firm' (2008) 65 *Washington & Lee Law Review* 711, at 726.
[15] See, e.g., F. Partnoy and D.A. Skeel Jnr., 'The Promise and Perils of Credit Derivatives' (2007) 75 *University of Cincinnati Law Review* 1019.
[16] D. Awrey, 'The Limits of Private Ordering in Modern Financial Markets' (2015) *Review of Banking and Financial Law* (forthcoming): available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2262712
[17] See, generally, IOSCO, *Report on the Credit Default Swap Market* (June 2012): available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD385.pdf
[18] See, e.g., E.J. Swan, *Building the Global Market: A 4000 Year History of Derivatives* (London: Kluwer, 2000).
[19] See, e.g., M. D. West, 'Private Ordering at the World's First Futures Exchange' (2000) 98 *Michigan Law Review* 2574.

instruments, such as options and futures. Major derivatives exchanges have historically been self-regulatory organisations (SROs) and have also become subject to a degree of direct public regulatory oversight over time.[20] Notably, exchange-traded derivatives markets have developed a robust market infrastructure, exemplified by the utilisation of central clearinghouses ('CCPs') to intermediate transactions and dampen risks[21] (to which we will return later in this article).

Throughout history, privately negotiated tailored ('bespoke') derivatives have also been traded in the shadow of the organised exchanges on an 'over-the-counter' (OTC) basis. Initially, the common law and statutory provisions in major trading jurisdictions were inhospitable to these instruments. This was attributable, inter alia, to the conflation of such off-exchange trading with surreptitious wagering, as well as concerns regarding the inflation of speculative bubbles facilitating significant losses with potentially wider implications.[22] Once public policy towards OTC derivatives, particularly the burgeoning swaps market,[23] softened in the late twentieth century, they were initially invoked occasionally to fulfil niche hedging strategies. However, this altered significantly throughout the 1990s and 2000s when OTC instruments, including CDSs, became widely traded[24] in their own right, in pursuit of purely speculative[25] activities and regulatory arbitrage.[26]

Today the OTC derivative markets are mainly populated by sophisticated participants. These include the largest global dealer banks ('G18'),[27] other financial institutions, hedge funds, sovereigns and governmental entities (such as local authorities) and corporations. Small and medium enterprises (SMEs), as well as high net worth individuals, also participate to some extent within certain segments of the OTC derivative markets.[28] Furthermore, intermediaries such as inter-dealer brokers and professional services firms, including the major law and accountancy houses, play important supporting roles in the OTC derivative markets in general. In terms of the complexion of participants in the CDS markets specifically, these have mainly tended to be 'institutional' in nature, 'without a

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[20] See, e.g., G. Poitras, 'From Antwerp to Chicago: The History of Exchange-Traded Derivative Security Contracts' (2009) 20 *Revue d'Histoire de Sciences Humaines* (2009) 11; S.C. Pirrong, 'The Self-Regulation of Commodity Exchanges: The Case of Market Manipulation' (1995) 38 *Journal of Law and Economics* 141.

[21] See, e.g., F.R. Edwards, 'The Clearing Association in Futures Markets: Guarantor and Regulator', 3 *Journal of Futures Markets* (1983) p. 369.

[22] B. Sapien, 'Financial Weapons of Mass Destruction: From Bucket Shops to Credit Default Swaps' (2010) 19 *Southern California Interdisciplinary Law Journal* 411; L.A. Stout, 'Why the Law Hates Speculators: Regulation and Private Ordering in the Market for OTC Derivatives' (1999) 48 *Duke Law Journal* 701; J. P. Raines and C.G. Leathers, 'Financial Derivative Instruments and Social Ethics' (1994) 13 *Journal of Business Ethics* 197; S. Borna and J. Lowry, 'Gambling and Speculation' (1987) 6 *Journal of Business Ethics* 219.

[23] See, e.g., R. Hodgson, 'The Birth of the Swap' (2009) 65 *Financial Analysts Journal* 1.

[24] See, e.g., D. Bryan and M. Rafferty, 'Financial Derivatives: The New Gold?' (2006) 10 *Competition and Change* 265.

[25] On pure speculation in OTC derivatives markets see, e.g., T.E. Lynch, 'Gambling by Another Name; The Challenge of Purely Speculative Derivatives' (2011) 17 *Stanford Journal of Law, Business and Finance* 67; Stout above n. 22.

[26] See, e.g., G. Tett, *Fools Gold: How Unrestrained Greed Corrupted a Dream, Shattered Global Markets and Unleashed a Catastrophe* (London: Little, Brown 2009); F. Partnoy, 'Financial Derivatives and the Costs of Regulatory Arbitrage' (1997) 22 *Journal of Corporation Law* 211. On regulatory arbitrage generally see V. Fleischer, 'Regulatory Arbitrage' (2011) 89 *Texas Law Review* 227.

[27] See, e.g., ISDA, *Major Banks Agree to Sign ISDA Resolution Stay Protocol* (11 October 2014): available at http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol

[28] See, e.g., UK Financial Services Authority, *FSA Agrees Settlement with Four Banks over Interest Rate Hedging Products* (29 June 2012): available at http://www.fsa.gov.uk/library/communication/pr/2012/071.shtml

significant "retail" component'.[29] The dominant role of the dealers in the CDS markets was attested by the International Organization of Securities Commissions in a 2012 report which estimated that:

> [R]oughly 60% of the outstanding contracts (in terms of gross notional) are concluded between dealers...while the remaining share is represented by contracts between a dealer and a non-dealer – mostly financial – institutions.[30]

According to the Bank for International Settlements (BIS) the OTC (including CDS) market is considerably larger than the exchange-traded (ET) segment in notional terms[31], though it must also be emphasised that headline notional measurements do not reflect mark-to-market and 'netting'-related adjustments, coupled with collateralisation; which together generate a smaller 'net notional' figure.[32] Nonetheless, the OTC derivative markets (including the CDS segment), and the key participants within them, are systemically significant.[33]

Immediately prior to the GFC OTC derivatives were susceptible to less direct public regulatory oversight than the ET markets.[34] In particular, the OTC derivatives markets have historically lacked the well-developed market infrastructure, such as central clearing,[35] which characterised the ET markets. Instead, from the 1980s up until the GFC OTC derivative market participants primarily relied upon a dominant transnational private regulatory regime under the auspices of ISDA[36]; albeit a private regulatory regime that has historically been, and is perhaps even more so now, dependent upon the 'enrolment'[37] of public capacities. These public-private 'pathways of interaction'[38] have had the effect of buttressing ISDA's gatekeeper role in the OTC derivative markets generally.

ISDA as Gatekeeper and the Implications of the GFC

In principle, the concept of a gatekeeper can be fungible depending on the sector or context. A gatekeeper in the commercial space has been broadly defined by John Coffee as possessing:

> significant reputational capital, acquired over many years and many clients, which it pledges to assure the accuracy of statements or recommendations that it either makes or verifies...the gatekeeper receives a far

[29] ISDA, *Transparency in Credit Default Swap Markets* (1 July 2010): available at http://www2.isda.org/functional-areas/research/studies/page/3

[30] International Organization of Securities Commissions, *The Credit Default Swap Market* (June 2012): available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD385.pdf

[31] Compare BIS, *OTC Derivatives Market Activity in the Second Half of 2013*(8 May 2014): available at http://www.bis.org/publ/otc_hy1405.htm with BIS, *Exchange-Traded Derivatives Statistics* (14 September 2014): available at http://www.bis.org/statistics/extderiv.htm

[32] See C. Johnson, 'Regulatory Arbitrage, Extraterritorial Jurisdiction, and Dodd-Frank: The Implications of US Global OTC Derivative Regulation' (2014) 14 *Nevada Law Journal* 542.

[33] See, e.g., A. Blundell-Wignall and P.E. Atkinson, 'Global SIFIs, Derivatives and Financial Stability' (2011) *OECD Journal, Financial Market Trends* (Issue 1). On systemic risk more generally see, e.g., S.L. Schwarcz, 'Systemic Risk' (2008) 97 *Georgetown Law Journal* 194.

[34] See, e.g., L.A. Stout, 'The Legal Origin of the 2008 Credit Crisis' (2011) 1 *Harvard Business Law Review* 301.

[35] See, e.g., C. Pirrong, 'The Clearinghouse Cure' (2009) *Regulation* 44, at 45-46.

[36] For further discussion of ISDA see, e.g., H. McKeen-Edwards and T. Porter, *Transnational Financial Associations: Assembling Wealth and Power* (New York: Routledge 2013).

[37] See J. Black, 'Enrolling Actors in Regulatory Processes: Examples from UK Financial Services Regulation' (2003) *Public Law* 62.

[38] Eberlein et al., above n. 2.

> smaller benefit or payoff for its role, as an agent, in approving, certifying or verifying information than does the principal from the transaction that the gatekeeper facilitates or enables.[39]

Frank Partnoy has characterised reputational capital as, inter alia, a reservoir of 'goodwill' which:

> leads parties to include 'trust' as a factor in their decision-making; trust enables parties to reduce the costs of reaching agreement. Reputational capital is especially valuable when a small number of actors interact repeatedly.[40]

Gatekeepers endowed with the requisite reputational capital and which have become involved in certification or verification functions in the financial sector have traditionally been considered to encompass the likes of auditors, credit rating agencies, securities analysts, securities underwriters and lawyers.[41] Such gatekeepers have taken on vital functions in the operation of financial markets, supporting the credibility and compliance of key market actors in respect of a wide variety of different kinds of transactions, most centrally those relating to the taking on of debts. The capacity for gatekeeping typically derives from the market position of the gatekeeper, though public actors, such as regulators, may also (explicitly or implicitly) place dependence on the capacity and reputation of gatekeepers.[42]

We consider that trade associations performing the suite of functions that ISDA does can also be considered to qualify as 'approvals, certifications and verifications'. Therefore, ISDA can be located within this concept of a gatekeeper, through its contractual nexus with its members and its engagement with banks and others over the drafting of its standardised contract; which constitutes the 'boilerplate'[43] terms for the overwhelming majority of OTC derivatives transactions. In what follows, we illustrate why this is the case with reference to ISDA's multifaceted regulatory regime and the important role of 'pathways of interaction'[44] with public actors in underpinning ISDA's gatekeeping role.

Pathways to the Gatekeeper: ISDA's Multifaceted Regulatory Regime

ISDA is the principal transnational trade association and standard-setter for the OTC derivatives markets. It was officially founded in the mid-1980s (initially named the International Swaps Dealers Association), at a time when new OTC derivative products and pricing models were emerging.[45] A key trigger for ISDA's formation was an enquiry from the US Financial Accounting Standards Board

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[39] J.C. Coffee Jnr., 'Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms' (2004) 84 *Boston University Law Review* 301, at 308.
[40] Partnoy above n. 10, at 628.
[41] See, e.g., J.C. Coffee, *Understanding Enron: 'It's About the Gatekeepers Stupid'* (Columbia Law & Economics Working Paper No. 207, 2002): available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=325240
[42] See, e.g., J. Biggins and C. Scott, 'Public-Private Relations in a Transnational Private Regulatory Regime: ISDA, the State and OTC Derivatives Market Reform' (2012) 13 *European Business Organization Law Review* 307.
[43] On boilerplate see, e.g., K.E. Davis, 'The Role of Nonprofits in the Production of Boilerplate' (2006) 104 *Michigan Law Review* 1075; M. Kahan and M. Klausner, 'Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")', 83 *Virginia Law Review* (1997) 713.
[44] Eberlein et al., above n. 2.
[45] R.C. Merton, 'Theory of Rational Option Pricing' (1973) 4 *Bell Journal of Economics and Management Science* 141; F. Black and M. Scholes, 'The Pricing of Options and Corporate Liabilities (1973) 81 *Journal of Political Economy* 637.

regarding the treatment of swap instruments as 'off-balance sheet' items by major dealer banks.[46] As such, ISDA was established by, and for, the main OTC dealer banks but its membership constituency (now over 800) has since expanded to encompass a broad range of other market participants.[47] Nevertheless, the 'primary member' dealer banks have arguably continued to wield the majority of influence within ISDA since its foundation.[48]

Another of ISDA's other major early objectives was to defend copyright to an industry-developed standard ('boilerplate') contract for OTC derivatives transactions, now known as the ISDA Master Agreement, and related documentation; such as product definitions. The Master Agreement was the progeny of a period of bargaining between the major OTC derivative dealer banks and represented an attempt to boost legal certainty and minimise transaction costs in the relatively nascent, but potentially lucrative, OTC financial derivatives markets.[49] As a result, the Master Agreement and related documentation are now the dominant standards for OTC derivatives transactions across the main trading jurisdictions.[50] ISDA's initial mission also encapsulated lobbying activities extending beyond, though ultimately related to, its role as vanguard of the Master Agreement.

Faced with a certain degree of public regulatory ambiguity towards new OTC products in the late 1980s and 1990s in the large US and UK markets,[51] and against a politico-economic backdrop espousing the primacy of the 'efficient markets hypothesis',[52] ISDA's lobbying was salient. Given that ISDA's membership encompasses some of the largest financial institutions on the globe, its influence and apparent expertise were duly recognised by public policy makers. Overall, ISDA can be considered to have been pivotal in shepherding a public deregulatory trend; climaxing in the late 1990s/early 2000s with the enactment of OTC derivatives-friendly legislation, such as the Commodity Futures Modernization Act (CFMA) in the US for instance.[53]

More broadly, ISDA and/or some of its major members have successfully encouraged national governments to enact legislative 'safe harbours', incorporating exemptions from bankruptcy and gaming laws for OTC derivatives[54]; with a view to ensuring that smooth settlement ('close-out

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[46] F. Partnoy, *Infectious Greed: How Deceit and Risk Corrupted the Financial Markets* (Philadelphia: PublicAffairs 2009), pp. 43-44.

[47] ISDA, *ISDA Members List*: available at https://www2.isda.org/membership/members-list/.

[48] See, e.g., R.E. Litan, *The Derivatives Dealer's Club and Derivatives Markets Reform: A Guide for Policy Makers, Citizens and Other Interested Parties* (Brookings Institute, April 2010) p.30: available at http://www.brookings.edu/~/media/research/files/papers/2010/4/07%20derivatives%20litan/0407_derivatives_litan.pdf

[49] See, e.g., S.M. Flanagan, 'The Rise of a Trade Association: Group Interactions within the International Swaps and Derivatives Association' (2001) 6 *Harvard Negotiation Law Review* 211; J.B. Golden, 'Setting Standards in the Evolution of Swap Documentation' (1994) 13 *International Financial Law Review* 18.

[50] For instance, as at end-2013 87 per cent of credit support documentation in non-cleared OTC trades used the ISDA standard. See ISDA, *Margin Survey 2014*(10 April 2014): available at http://www2.isda.org/functional-areas/research/surveys/margin-surveys/.

[51] See, e.g., D. Awrey, 'The FSA, Integrated Regulation and the Curious Case of OTC Derivatives' (2010) 13 *University of Pennsylvania Journal of Business Law* 1.

[52] On efficient capital markets theory see, e.g., E.F. Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) *Journal of Finance* 383.

[53] See Stout above n. 34 ; M. Greenberger, 'Overwhelming a Financial Regulatory Black Hole with Legislative Sunlight: Dodd-Frank's Attack on Systemic Economic Destabilization Caused by an Unregulated Multi-Trillion Dollar Derivatives Market' (2011) 6 *Journal of Business and Technology Law* 127; Partnoy, above n. 46, p. 293.

[54] And which can also encompass other instruments, such as repurchase agreements ('repos').

netting')[55]for OTC derivative contracts is legally protected. ISDA's (contestable)[56] posture is that these safe harbours are crucial for guaranteeing legal certainty and thereby underpinning financial stability. Additionally, enactment of such legislation is often explicitly or implicitly positioned as being central to ensuring an attractive environment for financial services businesses and, more specifically, supporting the growth of OTC derivatives markets.[57]

In fact, ISDA offers a 'model netting law'[58] as a template for enactment of such legislation and there are clear examples of national legislators having followed the substance, if not the form, of this instrument.[59] Although ostensibly a 'technical' matter, these interactions thus carry strong normative undertones.[60] ISDA also arguably exerts subtler forms of influence by actively engaging in legal harmonisation initiatives encompassing public and private actors, for instance under the auspices of the International Institute for the Unification of Private Law (UNIDROIT).[61]

Other mechanisms invoked to underpin the integrity of OTC derivative market norms, as well as ISDA's gatekeeper role, include ISDA's commissioning of legal opinions regarding the enforceability of the Master Agreement and associated collateral (security) arrangements across jurisdictions.[62] Coupled with choice of law clauses and accompanying guidance embedded within the Master Agreement, as well as related documentation, these mechanisms have the clear aim of confining litigation to jurisdictions that are less likely to deliver major interpretative shocks to ISDA's

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[55] Defined as 'a process involving termination of obligations under a contract with a defaulting party and subsequent combining of positive and negative replacement values into a single net payable or receivable' in D. Mengle, *Close Out Netting and Risk Management in Over-the-Counter-Derivatives* (Working Paper, June 2010): available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1619480; See also P. Werner, *The Importance of Close Out Netting* (ISDA: Research Notes No.1/2010, 2010): available at http://www2.isda.org/search?keyword=netting.

[56] See, e.g., D. Duffie and D.A. Skeel Jnr., *A Dialogue on the Costs and Benefits of Automatic Stays for Derivatives and Repurchase Agreements* (University of Pennsylvania Institute for Law & Economics Research Paper No. 12-02, March 2012): available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1982095; M.J. Roe, 'The Derivatives Market's Payment Priorities as Financial Crisis Accelerator' (2011) 63 *Stanford Law Review* 539; S.J. Lubben, 'Repeal the Safe Harbours' (2010) 18 *American Bankruptcy Institute Law Review* 319; Robert R. Bliss & George G. Kaufman, 'Derivatives and Systematic Risk: Netting, Collateral and Closeout', (2006) 2 *Journal of Financial Stability* 55.

[57] See, e.g., ISDA, *ISDA Submission to Indian Authorities on Consistency of Netting Application to Spur Economic Growth* (12 October 2012): available at http://www2.isda.org/search?headerSearch=1&keyword=netting.

[58] ISDA, *Model Netting Act*: available at http://www.isda.org/docproj/model_netting.html

[59] See, e.g., A. Riles, *The Transnational Appeal of Formalism: The Case of Japan's Netting Law* (Stanford/Yale Junior Faculty Forum Research Paper 00-03, 2000) pp. 29-30: available at http://ssrn.com/paper.taf?abstract_id=162588 (Japan); Biggins and Scott above n. 42, at 329-332 (Ireland).

[60] See, e.g., Biggins and Scott above n. 42; G. Morgan, 'Market Formation and Governance in International Financial Markets: The Case of OTC Derivatives' (2008) 61 *Human Relations* 637. More generally, it has been questioned whether even the most technical areas of private governance can ever be free of political contestation affecting interests: T. Büthe, and W. Mattli, *The New Global Rulers: The Privatization of Regulation in the World Economy* (Princeton, NJ: Princeton University Press, 2011).

[61] UNIDROIT, *Principles and Rules on the Netting of Financial Instruments*: available at http://www.unidroit.org/english/studies/study78c/main.htm

[62] ISDA, *Opinions*: available at http://www2.isda.org/functional-areas/legal-and-documentation/opinions/; See, e.g., ISDA, *ISDA Margin Survey 2012* (1 May 2012): available at http://www2.isda.org/functional-areas/research/surveys/margin-surveys/ ; For discussion see A. Riles, 'The Anti-Network: Private Global Governance, Legal Knowledge, and the Legitimacy of the State' (2008) 56 *American Journal of Comparative Law* 605, at 612.

interests.[63] ISDA also intervenes as *amicus* in court cases which are deemed to raise important policy issues for the OTC derivative markets.[64]

In addition, while alternative dispute resolution was not a pervasive mechanism in the OTC derivative markets prior to the GFC, it is now reportedly gaining popularity amongst market participants.[65] In this sphere, ISDA has assumed a key role within a recent high-profile initiative, known as the Panel of Recognised International Market Experts in Finance (P.R.I.M.E. Finance).[66]

Taken together, it is clear that ISDA has nurtured significant 'pathways of interaction'[67] between the OTC derivative industry and public actors (both legislative/governmental and juridical). In turn, these pathways of interaction have been crucial to maintaining a hospitable environment for OTC derivative transactions. And these relationships have been self-reinforcing in the sense that ISDA's success in paving and maintaining these pathways with external actors ensured that it could muster sufficient reputational capital to maintain its gatekeeper position in the OTC derivative markets prior to the GFC.[68]

Gatekeeper under Siege: The GFC

We are not concerned here with exhaustively recounting the debates around the fundamental causes of the GFC (which can be analysed from both regulatory and monetary policy angles).[69] What can be said is that derivatives, including CDSs, played a role in the GFC. Amongst other things, this role was attributable to an interplay between CDS deployment and securitisation practices[70]; the resulting interconnectedness between systemic market participants;[71] informational asymmetries;[72]

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[63] See, e.g., J. Biggins, '"Targeted Touchdown" and "Partial Liftoff": Post Crisis Dispute Resolution in the OTC Derivatives Markets and the Challenge for ISDA' (2012) 13 *German Law Journal* 1297. See also, e.g., J.P. Braithwaite, 'Standard Form Contracts as Transnational Law: Evidence from the Derivatives Markets' (2012) 75 *Modern Law Review* 779; J. Black and D. Rouch, 'The Development of the Global Markets as Rule-Makers: Engagement and Legitimacy' (2008) 2 *Law and Financial Markets Review* 218.

[64] ISDA, *Amicus Briefs*: available at http://www2.isda.org/functional-areas/legal-and-documentation/amicus-briefs/; J.P. Braithwaite, 'OTC Derivatives, the Courts and Regulatory Reform' (2012) 7 *Capital Markets Law Journal* 364, at 367-368.

[65] See, e.g., ISDA, *ISDA Publishes the 2013 Arbitration Guide* [http://www2.isda.org/news/isda-publishes-the-2013-isda-arbitration-guide].

[66] [http://www.primefinancedisputes.org/]. For discussion see J. Golden, 'Judges and Systemic Risk in the Financial Markets' (2013) 18 *Fordham Journal of Corporate and Financial Law* 327.

[67] Eberlein et al., above n. 2.

[68] For an illustration of the implications of ISDA's accumulated reputational capital in the context of the 1990s Japanese financial crisis see A. Gelpern, "Commentary: Public Promises and Organizational Agendas" (2009) 51 *Arizona Law Review* 57.

[69] On the GFC and its aftermath generally see, e.g., T. Porter, *Transnational Financial Regulation After the Crisis* (Oxford and New York: Routledge, 2014); E. Helleiner, 'Understanding the 2007-2008 Global Financial Crisis: Lessons for Scholars of International Political Economy' (2011) 14 *Annual Review of Political Science* 67; A.E. Wilmarth Jnr., 'The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis' (2009) 41 *Connecticut Law Review* 963; M.K. Brunnermeier, 'Deciphering the Liquidity and Credit Crunch 2007-2008' (2009) 23 *Journal of Economic Perspectives* 77.V. Reinhart, 'A Year of Living Dangerously: The Management of the Financial Crisis in 2008' (2011) 25 *Journal of Economic Perspectives* 71.

[70] See, e.g., M.N. Bailey, R.E. Litan and M.S. Johnson, *The Origins of the Financial Crisis* (Brookings Fixing Finance Series, November 2008): available at http://www.brookings.edu/about/projects/business/fixing-finance

[71] See, e.g., R.M. Lastra, 'Systemic Risk, SIFIs and Financial Stability' (2011) 6 *Capital Markets Law Journal* 197.

the form and implementation of public regulatory frameworks;[73] and the idiosyncrasies of human[74] (mostly male)[75] actors. And while some market participants reaped substantial rewards for being on the 'right side' of CDS contracts during the GFC,[76] a number of others, not least the systemically important insurance giant American International Group (AIG), were much less fortunate.

While the proximate reasons for AIG's collapse have been extensively outlined elsewhere,[77] it is clear that AIG (specifically its Financial Products division) engaged in a considerable degree of speculative activity in the CDS markets[78] and at the same time did not observe prudent margining (collateral) practices. These activities significantly contributed to a pooling of risk within AIG and the creation of systemically important interconnections, which AIG was unable to extricate itself from as the GFC flared up in 2007and 2008.

Accordingly, ISDA (as well as other observers) tend to characterise AIG's predicament as somewhat *sui generis*.[79] But irrespective of whether AIG's specific situation may have technically been *sui generis*, the fact remains that AIG's foray into the CDS markets and subsequent difficulties contributed to negative externalities. Fearful of the systemic implications of AIG's collapse, US public authorities ultimately felt compelled to step in and support it with public funding, thereby also ensuring that AIG's outstanding obligations on its OTC derivatives portfolio were honoured.[80] In sum, the rescue of AIG, partly attributable to its CDS-related activities, generated a social cost. Of course, AIG was not the only financial institution to require publicly-funded assistance in the throes of the

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[72] See, e.g., R. Bartlett III, 'Inefficiencies in the Information Thicket: A Case Study of Derivatives Disclosures during the Financial Crisis' (2010) 36 *Journal of Corporation Law* 1.

[73] See, e.g., E.K. Gerding, 'Code, Crash and Open Source: The Outsourcing of Financial Regulation to Risk Models and the Global Financial Crisis' (2009) 84 *Washington Law Review* 127; UK Financial Services Authority, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (March 2009): available at www.fsa.gov.uk/pubs/other/turner_review.pdf ; European Commission, *Report of the High-Level Group on Financial Supervision in the EU* (25 February 2009): available at http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf

[74] See, e.g., D.C. Langevoort, 'Chasing the Greased Pig Down Wall Street: A Gatekeeper's Guide to the Psychology, Culture and Ethics of Financial Risk Taking' (2011) 96 *Cornell Law Review* 1209; S. Rosen, 'The Economics of Superstars' (1981) 71 *American Economic Review* 845; R.H. Thaler and E.J. Johnson, 'Gambling with the House Money and Trying to Break Even: The Effects of Prior Outcomes on Risky Choice' (1990) 36 *Management Science* 643.

[75] See, e.g., See, e.g., C.L. Apicella et al., 'Testosterone and Financial Risk Preferences' (2008) 29 *Evolution and Human Behaviour* 384; J.M. Coates and J. Herbert, 'Endogenous Steroids and Financial Risk Taking on a London Trading Floor' (2008) 105 *Proceedings of the National Academy of Sciences of the United States of America* 6167.

[76] See, e.g., M. Lewis, *The Big Short: Inside the Doomsday Machine* (New York: W.W. Norton, 2010).

[77] See, e.g., US Government Accountability Office, *Financial Crisis: Review of Federal Reserve System Financial Assistance to American International Group plc.* (Report to Congressional Requesters: September 2011): available at http://www.gao.gov/assets/590/585560.pdf; W.K. Sjostrum Jnr., 'The AIG Bailout' (2009) 66 *Washington and Lee Law Review* 943.

[78] R.M. Stulz, 'Credit Default Swaps and the Credit Crisis' (2010) 24 *Journal of Economic Perspectives* 73, at 83.

[79] ISDA, *AIG and Credit Default Swaps* (November 2009): available at: www.isda.org/c_and_a/pdf/ISDA-AIGandCDS.pdf

[80] For details see, e.g., US Office of the Special Inspector General of the Troubled Asset Relief Program, *Quarterly Report to Congress* (30 January 2010), p. 9: available at http://www.sigtarp.gov/Quarterly%20Reports/January2010_Quarterly_Report_to_Congress.pdf; ISDA, *Counterparty Credit Risk Management in the US Over-the-Counter Derivatives Markets* (August 2011): available at http://www2.isda.org/search?headerSearch=1&keyword=monoline

GFC[81] but is illustrative for present purposes insofar as its exposure to CDSs was a factor in its distress.

Following the rescue of AIG, OTC derivative market regulatory reform gained momentum and ISDA found itself on the defensive, in relation to AIG specifically as well as ISDA's alleged broader failure in the eyes of many to address market practices that were considered to have contributed to the outbreak of the GFC. Perhaps indicative of this pressure, ISDA published a somewhat terse statement on AIG in late 2009. In that statement ISDA essentially blamed AIG for its own downfall, sought to shift the emphasis away from AIG's CDS activities and warned stakeholders against drawing wider inferences from the AIG episode.[82]

ISDA's reputational capital was seemingly depleting. By 2010 Gillian Tett, writing for the *Financial Times*, was observing that 'the word "ISDA" has become distinctly toxic in Washington and Brussels' political circles'.[83] Tett also ventured:

> Precisely because it believed so deeply in its own free-market rhetoric, it failed to prevent the crazy abuses of the credit bubble. And because it felt so politically self-confident – having won those 1990s lobbying battles – it failed to spot the risk of a political backlash.[84]

It appeared that ISDA's pathways to public actors were eroded, its reputational capital was draining and, given the extent of the public regulatory reforms being mulled,[85] it was not clear that ISDA could fully retain its gatekeeper role in the OTC derivative markets. However, despite this seeming upheaval, ISDA was simultaneously vested with a new and significant regulatory responsibility in the CDS markets, in the form of the DCs. We now consider the background to the establishment of the DCs and their key features, before attempting to contextualise them, particularly in terms of the 'regulatory licensing' concept.

III. Emergence and Significance of the ISDA Credit Derivatives Determinations Committees

As the GFC began to bite in March 2008, the US President's Working Group on Financial Markets[86] (PWG) issued a policy statement outlining its assessment of the roots of market turmoil and recommendations for addressing it.[87] The prevailing industry settlement process for credit derivatives was amongst the issues which attracted the attention of the PWG.

Settlement Concerns

[81] See, e.g., A. Mody and D. Sandri, *The Eurozone Crisis: How Banks and Sovereigns Came to be Joined at the Hip* (IMF Working Paper 11/269, November 2011): available online at http://www.imf.org/external/pubs/ft/wp/2011/wp11269.pdf .
[82] See above n. 79.
[83] G. Tett, "ISDA Needs to Reposition itself if it is to Regain Real Clout", *Financial Times* (26 August 2010).
[84] Ibid.
[85] See, e.g., G20, *Leaders' Statement* (Pittsburgh Summit, 24-25 September 2009): available at http://www.g20.utoronto.ca/2009/2009communique0925.html
[86] Comprising the US Department of the Treasury, Board of Governors of the Federal Reserve System, Securities and Exchange Commission and Commodity Futures Trading Commission.
[87] US Treasury, *Policy Statement on Financial Market Developments: The President's Working Group on Financial Markets* (13 March 2008): available at http://www.treasury.gov/resource-center/fin-mkts/Documents/pwgpolicystatemktturmoil_03122008.pdf (hereinafter 'PWG Report').

Prior to the GFC, CDS market participants retained a considerable degree of flexibility as to how exactly a contract could be settled upon the occurrence of a triggering 'credit event'. This could be achieved on the basis of 'physical settlement', requiring protection buyers to actually deliver defaulted securities to the protection seller in return for CDS payout. However, historically physical settlement was not always a realistic and efficient mechanism, as the amount of CDS contracts written could exceed the amount of bonds outstanding. There was no legal requirement that CDS market participants necessarily hold the underlying reference obligation and many market players did not only enter CDS contracts for hedging purposes. Accordingly, this had the capacity to prompt market-distorting searches for underlying bonds under the physical settlement mechanism.[88]

An alternative to physical settlement is 'cash settlement'. Under this mechanism, the CDS seller and buyer would determine a recovery rate, obviating a need to physically deliver the underlying reference obligation. But a challenge with this approach is that a fair reference price for the defaulting obligation has to be found.[89] With a view to ameliorating difficulties associated with both physical and cash settlement, ISDA had developed voluntary ad-hoc 'auction protocols' prior to the GFC but these had not been adopted industry-wide at the onset of the crisis.[90]

Divergences in settlement processes presented a particular problem for systemically important dealer banks[91] acting as market-makers in CDS transactions. Dealers attempting to ensure that their intermediated transactions were 'offsetting' from a risk-management perspective could be fatally undermined if transactions were not settling in a consistent manner.[92] In the midst of fraught conditions in early 2008, the PWG was thus concerned about 'the market impact such choices could have if multiple credit events were to occur simultaneously'.[93] Therefore, in the broader context of standardisation and preparations for increased central clearing of derivatives the PWG recommended that:

> Supervisors should urge the industry to promptly amend standard credit derivative trade documentation to provide for cash settlement of obligations stemming from a credit event, in accordance with the terms of the cash settlement protocol that has been developed but not yet incorporated into standard documentation.[94]

As a result of this, as well as subsequent engagement with the OTC Derivatives Supervisors Group (ODSG),[95] ISDA promulgated the 'Big Bang' and 'Small Bang' Protocols (hereinafter 'the Protocols').

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[88] See, e.g., J. Helwege et. al, *Credit Default Swap Auctions* (Federal Reserve Bank of New York Staff Report No. 372, May 2009): available at http://www.newyorkfed.org/research/staff_reports/sr372.html
[89] Ibid.
[90] Awrey above n. 16, p. 13.
[91] On the modalities of dealer failure see, e.g., D. Duffie, 'The Failure Mechanics of Dealer Banks' (2010) 24 *Journal of Economic Perspectives* 51.
[92] ISDA, *The ISDA Credit Derivatives Determinations Committees* (May 2012): available at http://dc.isda.org/
[93] PWG Report above n. 87, p. 19.
[94] Ibid.
[95] Under the coordination of the US Federal Reserve Bank of New York (FNY) and also comprising the US Federal Reserve Bank of Richmond, Office of the Comptroller of the Currency, New York State Banking Department, Connecticut State Banking Department, Federal Deposit Insurance Corporation, Commodity Futures Trading Commission, Securities and Exchange Commission, French Prudential Supervisory Authority, German Federal Financial Supervisory Authority, Japanese Financial Services Agency, Swiss Financial Market Supervisory Authority and UK Financial Services Authority (now restructured): http://www.newyorkfed.org/markets/otc_derivatives_supervisors_group.html

The Protocols essentially aimed to 'hardwire' the 'auction mechanism' into CDS contracts in order to ensure standardised interpretation and settlement processes.[96]

The saliency of the new interpretation processes spawning from the Protocols is of particular interest for the purposes of this article. Prior to the Protocols, divergences in settlement patterns were not the only concerns for policy makers. Disagreements between counterparties as to whether a triggering event had occurred in the first place also stoked legal, as well as economic, risk and occasionally prompted litigation; for instance following debt restructuring exercises by Argentina in the early 2000s.[97]

Therefore, in conjunction with streamlined settlement processes, ISDA's contractual Protocols also established centralised dedicated bodies which are responsible for issuing decisions as to whether triggering events have or have not occurred for the purposes of relevant CDS contracts. These bodies are known as the Credit Derivatives Determinations Committees (DCs).

Mechanics of the ISDA Credit Derivatives Determinations Committees

The DCs are governed by rules drawn up by ISDA, aspects of which are periodically updated to reflect emerging market trends or demands.[98] There are five regional DCs.[99] ISDA acts as a non-voting secretary to all of them. Hence, strictly speaking there is a distinction between the DCs and ISDA itself, though as has been observed elsewhere: 'assuming the process works as advertised, DC decisions over time should track ISDA preferences'.[100]

The DCs are composed of ten voting derivatives dealers and five voting non-dealers serving on rotation, as well as a non-voting consultative dealer and a non-voting consultative non-dealer. Central clearinghouses ('CCPs') have also been afforded 'observer' status on the DCs.[101] Membership of the DCs is reviewed annually.[102] Dealer membership is contingent on aggregate CDS trading volumes both globally and in the geographical market of the relevant DC.[103] Non-dealer members are selected on the basis of their size.

Membership of each regional DC is on an 'institutional' rather than 'person-specific' basis. ISDA stresses that DC members are also expected to fully adhere to prevailing legal and regulatory obligations, for instance in relation to insider trading and market manipulation.[104] Fundamentally, the DCs are charged with adjudicating, ad-hoc, on standard questions ('Potential DC Issue')[105] submitted to them by CDS market participants ('Eligible Market Participants' and 'Eligible CCPs'). These questions typically relate to whether a particular event has occurred with respect to a reference entity (for instance a corporate or sovereign) in accordance with ISDA's Credit Derivatives

[96] ISDA, *Auction Hardwiring*: available at http://www.isda.org/companies/auctionhardwiring/auctionhardwiring.html
[97] See, e.g., S. Choi and M. Gulati, 'Contract as Statute' (2006) 104 *Michigan Law Review* 1129.
[98] ISDA, *DC Rules*: available at http://www.isda.org/credit/revisedcrules.html
[99] Americas, Asia excluding Japan, Australia-New Zealand, Europe and Japan.
[100] A. Gelpern and M. Gulati, 'CDS Zombies' (2012) 13 *European Business Organization Law Review* 347, at 363.
[101] Sections 1.6-1.9, DC Rules above n. 98.
[102] See ISDA, *ISDA Announces Annual Determinations Committees Outcome* (31 March 2014): available at http://www2.isda.org/news/isda-announces-annual-determinations-committees-outcome0
[103] Section 1.3, DC Rules above n. 98.
[104] ISDA, DC Paper above n. 92.
[105] Section 2.1(a), DC Rules above n. 98.

Definitions, whether a settlement auction should be held, along with other auction-related modalities etc. It is necessary for a submitter ('Eligible Market Participant') to be party to a CDS contract incorporating the Protocols ('Relevant Transaction').[106] It is possible for questioners to shield their identity by submitting a so-called 'General Interest Question'.[107]

An ISDA DC can, *inter alia*, decline to consider requests that are deemed to purely relate to a bilateral dispute between two market participants.[108] Most questions must be accepted by at least one DC Voting Member,[109] which is intended to filter frivolous issues. Where votes proceed, they are taken on the basis of publicly available information.[110]The DCs are usually required to reach an 80 per cent supermajority in determinations.[111] If a DC fails to reach such a majority on a particular question, or if it voluntarily elects on certain matters, a question may be referred to a panel of external reviewers. External review panels are reportedly drawn from a pool of lawyers, retired judges, academics and other experts who can hear legal arguments and issue a determination, within certain procedural constraints.[112]

DCs are not mandated to accompany their 'Yes' or 'No' decisions with detailed reasoning. However, in August 2012 ISDA amended the DC Rules to facilitate the publication of a summary 'Meeting Statement',[113] although the informational value of these statements may vary somewhat from case to case.[114] In contrast, external review panels are seemingly expected to prepare a summary and analysis of their decisions and for these to be published by ISDA,[115] though it is worth noting that the external review process is rarely invoked. External review panels are also explicitly subject to conflict of interest controls,[116] whereas a similar obligation does not appear to attach to the conventional DC process.

IV. DCs in Action: Private Provenance, Social Significance

The DCs cannot only be considered an academically interesting private regulatory specimen tucked away in the corner of an opaque market and of primary interest to a small number of repeat players in that market. It is clear that the DCs have the capacity, albeit relatively infrequently, to assume key roles in broader market events with a wider interest and implication, especially where the subject matter is a sovereign or a nationalised financial institution. Here we highlight an example of what we term the 'socially significant' aspect of the DC mechanism.

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[106] Section 1.1(a), DC Rules above n. 98.
[107] Section 2.1(a), DC Rules above n. 98.
[108] Section 2.2(a), DC Rules above n. 98.
[109] Ibid.
[110] Section 2.1(b) and 3.1(a), DC Rules above n. 98.
[111] Section 2.3(a), DC Rules above n. 98.
[112] See, generally, Section 4, DC Rules above n. 98.
[113] [http://www2.isda.org/news/isda-publishes-amendments-to-the-credit-derivatives-determinations-committees-rules-to-further-improve-transparency] See Section 2.5(f), DC Rules above n. 98.
[114] Compare ISDA, *Irish Bank Resolution Corporation Credit Event Determination* (http://dc.isda.org/documents/2013/02/emea_determinations_committee_decision_13022013_ibrc.pdf) and *SNS Bank NV Credit Event Determination* (http://dc.isda.org/documents/2013/02/emea_determinations_committee_decision_13022013-sns-2.pdf).
[115] Section 4.6(f), DC Rules above n. 98.
[116] See, e.g., Section 4.1. DC Rules above n. 98.

Athenian Determination and Viennese Ripples: KA Finanz

In the midst of the Eurozone sovereign debt crisis, Greece (supported by the 'troika'[117]) engaged in a contentious 'quasi-voluntary' sovereign debt restructuring arrangement with private creditors.[118] As part of this exercise,[119] in March 2012 the Greek authorities activated so-called retroactive collection action clauses (CACs)[120] (which had been inserted into sovereign bond contracts through legislation). In essence, upon securing the support of a certain proportion of bondholders for the restructuring, these CACs purported to bind the remaining private creditors holding Greek law-governed bonds to the overall restructuring arrangement.

For holders of Greek CDSs (insuring the affected bonds), activation of the CACs in turn raised a question as to whether a CDS triggering event had occurred for the purposes of ISDA's Credit Derivatives Definitions. The DC for Europe was duly petitioned in this respect and on 9 March 2012 determined that a CDS-triggering 'restructuring credit event' had occurred.[121] It should be noted that this determination represented the culmination of a period of background jockeying between public and private stakeholders. In particular, it was preceded by controversy[122] regarding a determination by the DC for Europe only days earlier that a CDS triggering event had not occurred, inter alia, only by reason of the retroactive insertion of the CACs into the bond contracts. While these matters have been well treated elsewhere,[123] we are interested here in illustrating the 'socially significant' ripples felt further afield as a result of the DC determination ultimately triggering Greek CDSs.

A little known Austrian 'bad bank', KA Finanz (KF) had been siphoned off from Kommunalkredit Austria following its nationalisation in October 2008.[124]KF houses the securities and CDS portfolio remaining in the wake of this demerger and has been charged with its 'structured rundown'.[125] However, following the Greek restructuring and determination of the ISDA DC on 9 March 2012 KF issued a statement indicating that it would require further public funding support to cover its losses on Greek securities and CDS contracts.[126] In its interim results for 2012 KF confirmed:

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[117] A colloquialism for the European Commission, European Central Bank and International Monetary Fund group of lenders.

[118] Represented by another powerful financial association, the Institute of International Finance (IIF): http://www.iif.com/

[119] See, e.g., J. Zettlemeyer, C. Trebesch and M. Gulati, *The Greek Debt Exchange: An Autopsy* (Duke University Faculty of Law Working Paper, September 2012): available at http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5343&context=faculty_scholarship

[120] For general discussion of CACs see, e.g., M. Gulati and L. C. Buchheit, 'Drafting a Model Collective Action Clause for the Eurozone' (2011) 6 *Capital Markets Law Journal* 317.

[121] See ISDA, *Credit Event: The Hellenic Republic* (9 March 2012): available at http://dc.isda.org/cds/the-hellenic-republic-3/

[122] See, e.g., S. Forgione, 'Greek Debt Ruling Dangerous Precedent: PIMCO's Gross', *Reuters* (1 March 2012): available at http://www.reuters.com/article/2012/03/01/us-greece-bonds-pimco-idUSTRE8201D920120301

[123] Gelpern and Gulati above n. 100.

[124]B. Groendahl, 'Austria's Government Decides to Sell Nationalized Lender Kommunalkredit', *Bloomberg* (29 November 2011): available at http://www.bloomberg.com/news/2011-11-29/austrian-government-to-start-sale-of-nationalized-lender-kommunalkredit.html

[125] KA Finanz AG, *About us*: available at http://www.kafinanz.at/EN/About%20us/About+us.aspx

[126] KA Finanz AG, *Private Sector Involvement – Greece* (9 March 2012): available at http://www.kafinanz.at/uploads/Adhoc_Griechenland_KF_en_604_EN.pdf; Z. Schneeweiss & B. Groendahl, 'Austria Faces $1.3 Billion Bank Injection After ISDA Triggers Greek CDS', *Bloomberg* (9 March 2012): available

> The debt restructuring measures for the Republic of Greece implemented in the first quarter of 2012 had a significant impact on KF...which could not be covered by KF's capital base. To recapitalise KF, comprehensive capital measures, effective as of 31 December 2011, were agreed upon with the Republic of Austria....[127]

Accordingly, KF illustrated how the impact of a DC determination could, due to the embedded legal significance of the Protocols across the CDS markets, directly affect a third party (i.e. the Austrian State) and carry with it distributional implications. This is significant because, although the DCs can exert such third party effects, it does not necessarily follow that affected third parties have a right to input into DC processes.

Put differently, despite the fact that a DC determination could negatively affect a failed bank (i.e. KF) with legacy CDS exposures and which had come under public oversight, the Austrian public authorities were not entitled to appear before the DC or make submissions relating to the DC determination impacting KF; should they have wished to do so. Nor were the Austrian authorities seemingly entitled to appeal within ISDA structures against the DC determination, should they have been minded to do so; in comparison to a potential right of appeal against a decision of a court of law. Therefore, KF was arguably illustrative of the fact that a DC decision can exert third party (distributional) implications for a range of stakeholders; including government actors which themselves may have little, or no, direct proximity to the DC process itself. In that sense, we consider that this is illustrative of the capacity of DC determinations to be 'socially significant'.

This then begs a question as to how a potentially systemically important function, with a propensity to exert such externalities, is sustained in its current form, despite conflict of interest concerns associated with it. This is considered in the next section, where we also explore why ISDA's reputational capital, dominance and pre-existing gatekeeper role (while not insignificant) may be insufficient of themselves to explain this state of affairs. We then turn our attention to the part which public actors may be playing in underwriting the DC mechanism, as a result of the pathway of interaction forged by ISDA in the immediate post-GFC period, specifically through the lens of 'regulatory licensing'.[128]

V. Nothing is but what is not? The Public Pathway to the DCs

There are a number of plausible market-based explanations as to why the ISDA DCs came into existence and are capable of retaining their 'regulatory share'.[129] In the first instance, the concentrated nature of the OTC derivative markets, particularly the dominance of the dealer banks, is undoubtedly relevant when reflecting upon the complexion of the DCs. A theory put forth by Daniel Mügge may thus be quite instructive in this respect.[130]

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at http://www.bloomberg.com/news/2012-03-09/austria-faces-1-3-billion-bank-injection-after-isda-triggers-greek-cds.html .

[127] KA Finanz AG, *Interim Result 2012 of KA Finanz AG* (3 August 2012): available at http://www.kafinanz.at/uploads/PA_Halbjahresbilanz2012_KF_en_final_618_EN.pdf

[128] Partnoy above n. 10.

[129] See J. Black, *Legitimacy and the Competition for Regulatory Share* (LSE Legal Studies Working Paper No. 14/2009): available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1424654

[130] D. Mügge, 'Private-Public Puzzles: Inter-firm Competition and Transnational Private Regulation' (2006) 11 *New Political Economy* 177.

Mügge reasons that where industries become dominated by a group of 'producer' firms, particularly those which organise themselves through trade associations, they can, despite exogenous shocks, be well positioned to define aspects of regulatory reform agendas from the outset. Or, as Mügge puts it, 'suggest "solutions" to problems they themselves helped define'.[131] Accordingly, where such firms are faced with regulatory overhaul they may be capable of successfully warding off public intervention in certain complex areas (in this case CDS determinations) by offering '"tightened" self-regulation in return for public "oversight"'.[132] Daniel Awrey has also highlighted the importance of self-reinforcing "positive network externalities" when analysing the DC mechanism. Awrey considers that such network externalities arise 'wherever the addition of *new* users – or market participants ...generates benefits for *existing* users'. [133]

In the case of the DCs, Awrey attributes network externalities to their role in ISDA's broader standardisation activities, which assist in lowering various transaction costs in the OTC market. Consequently, the benefits and legitimacy of the DC mechanism are seen to be partly related to the extent to which the market adopts it. And given the degree to which ISDA documentation and norms are embedded within the OTC markets generally, Awrey concludes that any other private standard-setter seeking to supplant the DC mechanism would face a 'bleak calculus'.[134] Tony Porter has also reached a similar conclusion.[135] Through these market dominance-related dynamics, private actors can seek to construct a 'cognitive and political community, taking the role of the creator of the rules of the game'.[136]

However, the success of this endeavour can be uncertain. Huault and Rainelli-Le Montagner suggest that the creation of 'new rules of the game' in a technical market (such as OTC derivatives) still might not 'be expected to favour the adhesion of other actors who feel technically handicapped and uncertain about the potential opportunism of a small group of active promoters'.[137] This observation appears to be salient with respect to conflict of interest concerns expressed about the DCs and broadly two schools of thought can be detected in this regard. The first school of thought accepts that the DC mechanism is imperfect but is, from an efficiency perspective, a considerable improvement on the prior regime for interpreting and settling CDSs. This point of view is illustrated by the observation of a derivatives lawyer as follows:

> The DC is new, so any time there is a grey area you're going to get tension between dealers and buyside. But the DC has helped bring some certainty to the process, and it's a massive improvement on each individual party making its own decision and people holding off in the market to see what others do.[138]

ISDA itself has also mounted a defence of the DCs on the basis that the vast majority of questions considered by them are technical, straightforward and efficiently settled; that the 80 per cent

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[131] Ibid, at 185.
[132] Ibid.
[133] Awrey above n. 16, p. 9.
[134] Awrey above n. 16, pp. 27-28.
[135] T. Porter, 'Technical Systems and the Architecture of Transnational Business Governance' (2014) 8 *Regulation & Governance* 110-125.
[136] I. Huault and H. Rainelli-Le Montagner, 'Market Shaping as an Answer to Ambiguities: The Case of Credit Derivatives' (2009) 30 *Organization Studies* 549, at 567.
[137] Ibid.
[138] C. Whittall, 'IFR – Defending the ISDA Determinations Committee', *Reuters* (8 August 2011): available at http://uk.reuters.com/article/2011/08/08/derivatives-isda-dc-ifr-idUKL6E7J81Z720110808

supermajority mitigates conflicts of interests; and DC members are, in any event, obligated to observe relevant public regulations, such as anti-manipulation provisions.[139] On the face of it, ISDA's contentions carry merit insofar as the vast majority of the determinations issued by the DCs do seem to attract little or no public comment or interest.

The second school of thought is considerably less enamoured with the DC mechanism, especially on conflict of interest grounds, given that the firms sitting on the DCs are amongst the most active participants in the CDS markets. These concerns have occasionally boiled over in the context of particular DC determinations including, for example, Bradford & Bingley in 2009[140] and SEAT Pagine Gialle[141] in 2011. In the wake of a DC determination on SEAT, a market trader reportedly observed:

> The SEAT vote didn't seem very independent in the way people were voting on legal merit versus their position...How to enforce independent decision-making may not have been carefully thought out when the DC was set up....[142]

Daniel Awrey has also starkly articulated the overall conflict of interest concern as follows:

> We do not generally think it wise to permit judges to have a material interest in the cases they hear, to let students grade their own exams, or to allow referees to place bets on the games they officiate. *A priori*, there seems little justification for allocating authority to derivatives dealers to adjudicate issues which determine the payoffs under contracts – typically worth millions of dollars – to which they are themselves counterparties.[143]

Therefore, on the one hand it is clear that there were pre-existing market dominance-related dynamics which rendered it feasible for the industry to establish a new mechanism for enhancing efficiency in CDS interpretation and settlement. Nevertheless, the creation and endurance of the DCs as a constituent part of ISDA's overall portfolio as a gatekeeper may not be fully explainable under a market-based reputational capital analysis solely hinging on the prevalence of ISDA's contractual mechanisms and associated activities; for at least three reasons: Firstly, although ISDA seemingly enjoyed high reputational capital prior to the GFC, there appears to have been insufficient impetus to establish a DC mechanism earlier, despite pre-existing CDS interpretation and settlement challenges. Secondly, the DCs were established at a time when ISDA's reputational capital was seemingly at low ebb in the wake of the GFC. Thirdly, as highlighted, since their establishment concerns have been periodically voiced (including amongst CDS market participants) around potential conflicts of interest.

Taken together, these factors suggest that ISDA's market-based reputational capital alone is insufficient to explaining the establishment and endurance of the DC mechanism. In search of a fuller understanding as to the sources of the DCs sway, we next examine the role of public actors in offering a (if only implicit) backstop for the DCs legitimacy under the regulatory licensing concept.

Licensing for Legitimacy: The DCs and Regulatory Licensing

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[139] ISDA, DC Paper above n. 92.

[140] ISDA, *Credit Event: Bradford & Bingley*: available at http://dc.isda.org/cds/bradford-bingley-plc/; See also, C.M. Baker, 'Regulating the Invisible: The Case of Over-the-Counter Derivatives' (2010) 85 *Notre Dame Law Review* 1287.

[141] ISDA, *Credit Event: SEAT PAGINEGIALLE S.P.A*: available at http://dc.isda.org/cds/seat-paginegialle-s-p-a/

[142] C. Whittall, "Dealers Slam CDS Committee 'Bias'", *Reuters* (12 December 2011), available at: http://www.reuters.com/article/2011/12/12/seat-cds-idUSL6E7NC14E20111212

[143] Awrey above n. 16.

Frank Partnoy has argued that reliance upon a market-based reputational capital model alone to fully explain the preponderance of certain private gatekeepers is misguided. Partnoy has suggested that this is evident, inter alia, with respect to the functions of credit rating agencies (CRAs), especially prior to the GFC (which has triggered certain regulatory reforms in that area).[144] In illustrating the limitations of the reputational capital model in the credit rating agency context in the US, Partnoy points out that the informational value of credit ratings had in fact been declining over time and this had not gone unnoticed within the financial sector. For example, shortcomings in credit ratings were obvious in relation to Enron[145] and, in retrospect, even more obvious immediately prior to the outbreak of the GFC in relation to the subprime mortgage/securitisation markets. Yet, notwithstanding these shortcomings Partnoy highlights that CRAs actually increased in importance of over time.[146]

This paradox is attributed by Partnoy to the manner in which reliance on credit ratings was legally embedded in US securities legislation from the 1970s.[147] Broadly speaking, this regime facilitated relatively favourable regulatory treatment for financial instruments rated highly by, in practice, a small number of designated credit rating agencies, known as 'National Recognized Statistical Rating Organisations' (NRSROs); irrespective of the limited usefulness and predictive capacity of credit ratings issued by those NRSROs. Nonetheless, the ability of these NRSROs to facilitate favourable regulatory treatments of certain assets has been described by Partnoy as a public endowment of a lucrative power to grant 'regulatory licenses' upon private actors. According to Partnoy, this power, which has been divorced from the informational value of credit ratings per se, was attributable to the actions of public agencies in providing for ratings-dependent regulatory treatments within legal provisions.[148] As Partnoy observes, '[p]ut simply, credit ratings are important because regulations say they are'.[149]

At first blush, the manner in which the DCs were brought into existence and their ongoing functions do not seem to neatly resemble the example of CRAs operating under the NRSRO regime. The ISDA DCs do not, strictly speaking, trace their own power to explicit public statutory or regulatory 'enabling provisions' akin to the NRSRO regime. The DCs can only point to an immediate contractual, rather than statutory, underpinning. That said, the regulatory licensing analogy may nonetheless be a useful analytical tool for conceptualising the DCs.

In the first instance, although the DCs are not embedded in public legislation, ISDA evidently regards softer forms of public endorsement as an important backstop to the DCs' legitimacy. This is attested by ISDA's trumpeting of the fact that the Federal Reserve Bank of New York welcomed the

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[144] See, e.g., US Securities and Exchange Commission, *Credit Rating Agencies*: available at http://www.sec.gov/spotlight/dodd-frank/creditratingagencies.shtml

[145] See, e.g., F. Partnoy, *Enron and Derivatives* (24 January 2002): available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=302332 .

[146] Partnoy above n. 10.

[147] F. Partnoy, 'The Paradox of Credit Ratings' in *Ratings, Rating Agencies and the Global Financial System* (The New York University Salomon Center Series on Financial Markets and Institutions, Volume 9, 2002) pp 65-84.

[148] F. Partnoy, "Barbarians at the Gatekeepers?: A Proposal for a Modified Strict Liability Regime" (2001) 79 *Washington University Law Review* 491, at 509-510.

[149] Partnoy above n. 146, p. 66.

Protocols.[150] So although the regulatory outcome was of a private nature, it traced its roots to a public-private interaction and benefited from public regulatory endorsement.

Additionally, not unlike credit ratings, CDS instruments (rather than the DCs themselves per se) are explicitly referred to in various public legislative and regulatory provisions. The inclusion of CDSs in public ordinances can be motivated by concerns about regulating aspects of their usage.[151] But they are also referenced within certain public provisions as risk mitigation tools.[152] For instance, Article 216 of the EU Capital Requirements Regulation (CRR)[153] stipulates that, in order to qualify as eligible credit protection, cash-settled credit derivative contracts must, inter alia, exhibit the following features:

> ...(d) the identity of the parties responsible for determining whether a credit event has occurred is clearly defined;
>
> (e) the determination of the credit event is not the sole responsibility of the protection provider;...

Importantly, in the post-GFC environment and the resultant adoption of the Protocols with the support of public actors, participation in the CDS markets will, as a practical matter, usually be contingent upon adherence to ISDA documentation incorporating the Protocols.

Therefore, subsequent to the Protocols, the primary way in which a market participant may ensure compliance with the type of public regulatory provision above is through adherence to the ISDA DC mechanism and contractual apparatus around it. Given this practical reality, it could thus be argued that the DCs are, in effect, in a position to issue regulatory licenses which facilitate the usage of CDSs as risk mitigating tools in a manner permissible under public regulatory provisions; insofar as the DCs presently happen to fulfil the type of determination function referred to in Article 216 of CRR, for example. And the DCs' legitimacy for so doing is ultimately backstopped by public support (albeit tacit). Moreover, the indications are that the DCs' regulatory licensing capacity will extend to new domains in the wake of public regulatory reforms.

Licensing on the Tightrope of Regulatory Reform

In the wake of the GFC, public authorities across major trading jurisdictions have instigated significant overhaul of OTC derivative markets[154]; essentially with the objective of emulating key infrastructure already prevailing in the exchange-traded (ET) derivatives markets. With a view to mitigating risk and increasing transparency, an increased proportion of OTC derivatives will, where

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[150] Federal Reserve Bank of New York, *New York Fed Welcomes CDS Auction Hardwiring* (12 March 2009) [http://www.newyorkfed.org/newsevents/news/markets/2009/ma090312.html]; ISDA, *The ISDA Credit Derivatives Determinations Committees* (2012), p. 6.

[151] See, e.g., Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on Short Selling and Certain Aspects of Credit Default Swaps [2012] OJ L 86/1.

[152] See, e.g., Article 204 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L 321/6 (the "Capital Requirements Regulation"),

[153] Ibid.

[154] See, e.g., Financial Stability Board, *Seventh Progress Report on OTC Derivatives Reform Implementation* (8 April 2014): available at http://www.financialstabilityboard.org/publications/r_140408.htm

appropriate[155], be channelled through central clearinghouses (CCPs) and/or traded on exchanges or electronic platforms. OTC derivatives will also be reported to central trade registries and/or public authorities.

Essentially, CCPs are entities that stand in the middle of OTC derivative transactions and thereby become the counterparty to each market participant using their services. CCPs aim to ensure prudent risk management of trades, as well as smooth post-trade settlement. CCPs seek to mitigate risks by ensuring that contracts are, for instance, offsetting and making use of 'multilateral netting'.[156] CCPs are systemically important in their own right and sensitive to the failure of their members.[157] Therefore, in order to underpin their own viability, market participants utilising CCPs are subject to certain membership criteria and trading requirements.[158]

The precise operation of the CCP model will vary between major trading jurisdictions and not all OTC derivatives will be suitable for central clearing. Accordingly, although subject to enhanced capital and risk management requirements under prudential regulatory reforms, non-cleared OTC derivatives will continue to be largely traded privately and bilaterally under the ISDA Master Agreement. Specifically in relation to credit derivatives, including CDSs, it seems likely at time of writing that a considerable number of these contracts will continue to be traded in this space. In fact, ISDA itself has concluded as much.[159] Trading in non-cleared CDS will by and large continue to be governed by prevailing ISDA documentation and processes, including the DC mechanism.

Additionally, even CDS contracts subject to a clearing obligation may also be governed by the DC mechanism. This is evidenced by the fact that major CCPs have been co-opted onto certain ISDA DCs; albeit as observers.[160] ISDA has also published amendments to its rules enabling CCPs to explicitly afford the DCs jurisdiction over cleared CDS.[161] Taken together and despite broader market infrastructure reforms, these factors therefore seem to imply that the ISDA DCs are likely to continue to wield significant regulatory licensing powers outside, and possibly within, clearing processes.

Therefore, the ISDA DCs will continue to occupy a sensitive position in the financial markets. But this will also arguably force them to walk a somewhat precarious 'tightrope' in the context of broader

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[155] For instance, liquidity and legal standardisation will be relevant factors in determining the clearing and exchange-trading-eligibility of instruments.

[156] See, e.g., S.G. Ceccheti, J. Gyntelberg and M. Hollanders, 'Central Counterparties for Over-the-Counter Derivatives', *Bank for International Settlements Quarterly Review* (September 2009); E. Ledrut and C. Upper, 'Changing Post-Trading Arrangements for OTC Derivatives' (December 2007) *Bank for International Settlements Quarterly Review* 83.

[157] For discussion see, e.g., M.J. Roe, 'Clearinghouse Overconfidence' (2013) 101 *California Law Review* 1641.

[158] For further discussion of the CCP prescription see, e.g., C. Pirrong, *The Economics of Central Clearing: Theory and Practice* (ISDA Discussion Paper Series No. 1, May 2011): available at http://www2.isda.org/functional-areas/research/discussion-papers/; J.P Braithwaite, 'The Inherent Limits of "Legal Devices": Lessons for the Public Sector's Central Counterparty Prescription for the OTC Derivatives Markets' (2011) 12 *European Business Organization Law Review* 87.

[159] ISDA, *Non-Cleared OTC Derivatives: Their Importance to the Global Economy* (March 2013): available at www2.isda.org/...==/Non-Cleared%20OTC%20Derivatives%20Paper.pdf

[160] ISDA, *Current DC Members (effective April 28, 2014):* available at http://dc.isda.org/about-dc-committees/current-dc-members/

[161] ISDA, *Amendments to the ISDA Credit Derivatives Determinations Rules with Respect to Cleared Reference Entities* (9 September 2012): available at http://www.isda.org/credit/revisedcrules.html

public regulatory reforms. On the one hand, ISDA may be anxious to maintain as much 'regulatory share'[162] as possible through its apparent regulatory licensing power, while on the other avoid raising the hackles of public policy makers. However, threats to the DCs may flare up from time to time, especially in cases involving sovereigns or nationalised financial institutions which trigger a broader 'socially significant' interest or implication. Additionally, as has been demonstrated in other contexts, such as the interbank rate-setting controversy, socially important private governance arrangements are susceptible to direct public intervention in the event of perceived failures.[163] Indeed, by time of writing ISDA itself had been drawn into this controversy by virtue of a public regulatory investigation into ISDA's own (hitherto little known) derivatives benchmark rate ('ISDAFIX').[164]

The ISDA DCs will presumably be conscious that public intervention is a possibility and thus remain cognisant of their potential influence and associated responsibilities. At time of writing public policy makers have not indicated that they are inclined to interfere with the DC process and its associated regulatory licensing capacity. Nonetheless, certain issues around third party implications and potential conflicts of interest may continue to haunt the DCs. As such, in the longer term, stakeholders may be forced to consider the merits of further reform of overall *institutional governance* in these markets, as has already been mooted elsewhere.[165]

Conclusions

Notwithstanding the criticism meted out to private regulation during the GFC, and in the various post mortems, private regulators remain as core elements of the systems for setting and implementing the norms which govern the world's financial markets. In some cases the significance of private regulation has been enhanced as regimes have adapted to what was learnt about the prevalence of systemic risk arising out of global interdependence. The regulatory relationships in financial markets engage both private and public regulators and offer key examples of transnational business governance interactions (TBGI). Whilst in some cases public actors make a delegation explicit, as with credit rating agencies (though not necessarily specific ratings agencies), in other instances (as with ISDA) the delegation may be implicit, and may emerge through the unwillingness or inability of governments to fill regulatory vacuums or spaces within which private regulators may then act.

The story of the ISDA DCs which we told in this paper is an example of this latter kind in which ISDA demonstrates considerable resilience in the face of the GFC, innovating with new structures and processes to address decisions on credit defaults; affecting not only the parties to the transactions, but also third parties, including sovereign states. The source of the 'regulatory licence', as the

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[162] Black above n. 129.

[163] See, e.g., European Commission, *Statement by Commissioner Michel Barnier on Interbank Interest Rate Benchmarks* (8 February 2013): available at http://europa.eu/rapid/press-release_MEMO-13-82_en.htm; UK Treasury, *The Wheatley Review*: available at http://www.hm-treasury.gov.uk/wheatley_review.htm

[164] See, e.g., M. Leising, L. Fortado and J. Brunsden, 'Meet ISDAfix, the Libor Scandal's Sequel', *Bloomberg* (18 April 2013): available at http://www.businessweek.com/articles/2013-04-18/meet-isdafix-the-libor-scandals-sequel;

[165] See, e.g., K.N. Johnson, 'Things Fall Apart: Regulating the Credit Default Swap Commons' (2011) 82 *University of Colorado Law Review* 167, at 212-214; Baker above n. 140; D. Awrey, 'The Dynamics of OTC Derivatives Regulation: Bridging the Public-Private Divide' (2010) 11 *European Business Organization Law Review* 155.

concept is elaborated by us in this article, lies not only in the position of ISDA within contractual networks under which it originally supplied the rules (voluntarily adopted Master Agreements, as well as associated documentation) and in which it increasingly also supplies auxiliary implementation mechanisms such as the DCs; but also in an implicit public regulatory delegation to that contractually-based private regulatory regime. Hence, in this particular field, the character of TGBI derives as much from contracts as from traditional regulatory power, offering a core case both of gatekeeping and regulatory licenses in the implementation of private regulation with public significance.

We also deduce that, in similar spirit to the US NRSRO regime, CDS market participants have little choice but to rely on the ISDA DCs, given their contractually-based authority, current market realities and the support of public stakeholders; albeit a support which is implicit. However, this does not necessarily imply that the ISDA DCs should, as a normative matter, be issuing such licenses. Moreover, their political and legal authority for doing so seems comparatively more subliminal than the US NRSRO regime. We therefore consider that the DCs will only be in a position to continue discharging this function for as long as they enjoy the support of both ISDA members and public actors, with whom ISDA engages in TBGI. The role fulfilled by the DCs is theoretically capable of being carried out by another mechanism or structure if, for whatever reason, the legitimacy of the DCs were to drain away. And it could be speculated that the capacity of ISDA to retain the DC function in its present format may be partly contingent upon the manner in which the DCs handle their role in the context of 'socially significant' credit events in future.