* Starting Out

*To mark the start of ISDA's 40th year, **IQ** convened a group of derivatives pioneers to talk about the early days of the market, the reasons for ISDA's formation and its initial landmarks*

IQ: What were your first roles in the derivatives market?

Tom Jasper (TJ): I was at Salomon Brothers at the time, and I fell into interest rate swaps because no one at the firm had any idea what they were. But we were seeing interest rate swaps being transacted in London and I was asked by my boss to figure this out. Salomon had done the first currency swap between IBM and the World Bank, but the people involved at Salomon didn't know much about interest rate swaps. So, I did some sniffing around the market and started to get some sense for what they were and was terribly confused, but my job was to explain those instruments to everybody in New York. The question was who was going to be the counterparty, and we thought logically it would be a corporation. So, I went to the investment bankers and asked them to take me out to their clients to explain interest rate swaps. Of course, they were extraordinarily protective of their clients, and they didn't want to be embarrassed by taking some young vice president out to talk about something called interest rate swaps. Ultimately, I prevailed and had a few meetings with clients, but I can assure you it was very basic. Fortunately, they took a leap of faith that Salomon would figure it out and we completed the first transaction, and everybody was happy. This was before ISDA – it was probably 1982 or 1983.

Fast forward to the beginnings of ISDA. There was a very small group of people in the market doing interest rate swaps at the time and everybody knew each other. The big issue was that we could transact but it was incredibly tough to get documents negotiated and signed and we all had huge backlogs. That was the genesis for realising that something had to be done about this. We had a meeting in March 1984 to discuss how to take this forward. It was like the Wild West at the time. We were out doing transactions, and everybody was happy. I can assure you our back offices were not happy because of the documentation issue, and everybody understood this was a risk. So, that was the start of ISDA.

Jeffrey Golden (JG): I began my legal career at Cravath, Swaine & Moore and I acted as legal counsel in the early 1980s for what were then some of the earliest swaps. More importantly, I was lucky enough to be at the first meeting of the group that included lawyers in July 1984, acting for Salomon Brothers. As I recall, it was 11 banks gathered around the table to discuss standardising documentation, and my recollection is that I managed to attend every one of those small group meetings. Maybe more importantly, I got to be in the room when ISDA picked its name. Then it became my privilege with Dan Cunningham to hold the pen when writing the 1985 Code of Standard Wording, Assumptions and Provisions for Swaps, the 1986 code and the master agreements that flowed from that.

THE PARTICIPANTS

Mark Brickell, ISDA chairman 1988-1992

Jeffrey Golden, formerly Cravath, Swaine & Moore, drafting counsel for the first ISDA documents

Rick Grove, ISDA CEO 1997-2001

George Handjinicolaou, ISDA deputy CEO 2007-2009, 2011-2016

Carolyn Jackson, ISDA executive director 1995-1997

Tom Jasper, ISDA chairman 1985-1987

Patrick de Saint-Aignan, ISDA chairman 1987-1988

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> **Tom Jasper**

Patrick de Saint-Aignan (PSA): I was in the capital markets group at Morgan Stanley when the World Bank-IBM deal took place. Obviously, we thought we can't let a competitor get all the kudos, so I became the first product manager for currency swaps and then later also for interest rate swaps. Our office in London was very active at the time and a lot of innovation came from London. At that point, the Brits wanted it to call it a swop and not swaps, so they put up a bit of a struggle there. But eventually the name was decided and ISDA became the International Swap Dealers Association. Obviously, ISDA changed its name subsequently because it wanted to embrace the whole derivatives market and not just swaps. I think it was a brilliant move to keep the acronym but change the name to the International Swaps and Derivatives Association, and it also enabled us to bring non-dealers and end users as members of ISDA, which was somewhat controversial, but a lot of us felt it was desirable.

I remember, of course, the first meeting in Palm Beach, Florida in March 1984, when the decision was made to try and organise this activity, which, as Tom explained, suffered from complexity and a lack of standardisation. We were crumbling under the weight of documentation and the fear of having a three-yard-long telex as supporting documentation for a transaction that might not be documented for another year. So those were real concerns.

JG: I remember well the battle between the Brits and the Yanks about whether to spell 'swap' with an 'o' or an 'a'. I think we moved the needle on that because, when we did the 1985 code, we focused almost as much on the title as we did on what went between the pages. We came up with this idea that we were going to focus on wording, assumptions and provisions. If we could spell that out – Code of Standard Wording, Assumptions and Provisions for Swaps – and you read the first letter of each word, it spells swaps. We came up with the word 'assumptions', but we couldn't come up with a word beginning with 'o'. So, I think that won the day for swaps with an 'a'.

Mark Brickell (MB): My first contact with swaps came in 1984 or 1985. I had been assigned by JP Morgan to the funding operation of the bank to establish the base rate of interest on every fixed-rate loan we made in dollars from our US operation, from overnight out to 10 or 12 years. That brought me into contact with interest rate swaps as an end user. I sat in the bank's treasury using swaps and the prices on those swaps as a way to set rates for loans that went out far longer than the normal overnight, three-month or one-year horizon for a fixed-rate loan. Swaps were reducing costs and generating valuable information, and they took off.

Carolyn Jackson (CJ): In 1983, I had finished business school, and I joined Chase Manhattan Bank as the fifth and most junior member of the swaps team, which was part of the capital markets group within the investment banking division. The group had been set up by a person who had left Bankers Trust and had been working for Allen Wheat, one of the big names in the industry, so it was my boss's opportunity to see what he could do on his own to grow the team. What was interesting was that nobody wanted to be in this newly formed group at the time because it was so unknown what the success rate or trajectory would be for such a group.

George Handjinicolaou (GH): My start was on the buy side when I joined the funding department of the World Bank in 1983. The World Bank had discovered that issuing in Deutsche marks, yen, Swiss francs and later the euro and swapping the proceeds into US dollars would typically result in cheaper costs. As one of my first assignments, I was asked to make sense of a 200-page telex, which was essentially a confirmation. There was no standard documentation – just customised legal agreements and this one ran to about 200 →

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George Handjinicolaou

pages. Trying to decipher this was how I learned what a swap is, and I eventually wrote a handbook about swaps for the World Bank, which was used for several years. After that, I moved to the sell side at various organisations, including Security Pacific, Dresdner and UBS, and I was fortunate to watch the growth of this market, which probably exceeded everybody's expectations. There were very few people initially – maybe a couple of dozen globally and we all knew each other. I knew the market would grow because it was attracting the best people, but I never in my wildest dreams thought it would grow as big as it did.

Rick Grove (RG): In January 1984, I was a lawyer at Cravath, Swaine & Moore and was posted to London. It was very quiet, but Jeffrey Golden handed me what turned out to be an interest rate swap. I thought it was going to be one and done and I would never see another one. By the summer of 1984, I was working on hundreds of interest rate swaps. By the time I got back to New York in late 1985, I was put in charge of a group of 20 associates working on these transactions. On that desk, I had a red telephone that was a hotline connected to Tom Jasper's desk at Salomon Brothers and, anytime from 7:00am in the morning until deep into the evening, that phone would ring, and I'd answer it, and we'd try to work through the documentation backlog. Eventually, I decided to move to Paribas, where I was on the derivatives sales and trading desk for several years, before becoming chief executive of ISDA in 1997.

IQ: A couple of you have said you didn't expect the market to grow to the extent that it did. Was that view shared? Did you see this as a market with a long-term future?

MB: As an end user on JP Morgan's funding desk, it was very clear these contracts were reducing our funding cost, and they were also a valuable source of information about the yield curve for corporate fixed income. So, it seemed they had great potential. The bank soon moved me over to the dealer side, and the growth trajectory was so robust that the prospects looked really bright for the product, as long as we managed our operations, our accounting and our regulatory risk.

GH: You said it, Mark, because the growth was incredible, and then the first rain started falling in the back offices because of the backlogs. I think most of the firms that were involved in the early days got into trouble.

TJ: Again, part of the problem was there was no standardisation in the market. At Salomon, we wanted to trade these instruments, and you couldn't trade them unless you had something approaching a standard contract. So, that really became the Holy Grail. We envisioned the growth of the market – not as an agency-type business, but as a principal business where you could trade the contracts. That's where we saw the real growth, but you needed to have a standardised contract to get there.

JG: In the pre-ISDA days, being a swaps lawyer was three things. It was glamorous. I got my first Concord flights in that period because the margins justified it. A lot of exciting stuff was happening in London and some of us were sitting in New York, so we had to get back and forth quickly. It was exciting. There were immutable deadlines. You weren't going to put on the hedge without the underlying trade, and you weren't going to do the underlying trade until you were comfortable with the hedge. So, everything had to happen simultaneously. But if you kept your cool and you met those deadlines, then there were closing dinners, Lucite cubes and fountain pens – all the things that made it exciting for lawyers. But it was also frustrating. People fought, not because they were necessarily right, but because they were more familiar with their versions of the agreements. Different lawyers for different firms had produced their own contracts, and everybody was told 'don't change a word of it because you might undo the magic'. We had to figure out a way to cut through the time and cost it was taking to finalise the documents.

PSA: Most of us recognised the market could not develop unless there was some element of standardisation in the documentation. Also, clients hated it. They questioned why they needed to have a different agreement for Morgan Stanley, for Salomon Bothers and for Bankers Trust. There was tremendous pressure, not only because of the backlog, but simply because it would become more attractive and we could grow the business.

MB: It's true there was a focus on improving the documentation process, but I would broaden the theme to be greater than standardisation. To me, it was a collective effort to find more efficient ways to handle custom-tailored transactions. Yes, with respect to documentation, but also with respect to back-office activity and risk management.

RG: It may seem counterintuitive that standardising language was key to the growth of a market that is known for bespoke transactions. However, ISDA standard language is a library of terms from which transactions can be assembled in an infinite number of ways to suit the needs of the parties. Standardising language actually facilitated the growth of customisable OTC derivatives transactions.

GH: Another development that was critical to the growth of the market was when the banks stopped acting as arrangers and started to carry the position and hedge the risk until they found a counterparty. To me, that was one of the most critical transformations in the development of the market. It allowed the market to mushroom, but it put a burden on banks to hedge the risk and manage documentation.

IQ: ISDA was established in 1985 to bring greater standardisation to the market. How important was that development? Would the derivatives market have developed in the same way without it?

PSA: There were two objectives that guided the creation of ISDA. One was the standardisation of documentation – that was by far the most important objective. The second was to promote the development of swaps. The way of doing that was to publish volume statistics. We felt we could not get into the press because no one cared about it, but if we showed this was a market that was growing rapidly, then people would pay attention. That came back to haunt us later, as regulators started to worry about the growth of the derivatives market.

CJ: There needed to be some grouping of participants to decide how this market could best grow. We had many deals mature before the documents were actually in place, so it was critical. Without being able to have some discipline of documentation and getting those transactions documented, we would not have been able to grow, because having one or two deals that aren't documented properly – that's okay. But you can't necessarily grow into the thousands and then hundreds of thousands. So, I would say it was extremely critical to have that documentation base.

MB: ISDA was essential. But the way in which we did it was also important. There are two kinds of trade association. One trade association model is like a mediaeval guild – you erect barriers to entry against your competitors. That

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tends to ossify the business. We never did that. We were very careful to keep an open-source approach and never build the competitive moat. That meant that we had to compete not only with each other, but also with potential new entrants. As a result, we had to race faster than they did to be successful. That choice by ISDA helped generate the explosive success of the swaps business.

TJ: As mentioned earlier, there was the competition between New York and London in the early days. We knew ISDA had to be more than just a collection of New York dealers – it had to be a broader organisation than that. Kleinwort Benson was the token UK firm involved initially, so we knew we had to get the London dealers involved and then further broaden out the membership.

IQ: ISDA's first publication was the Code of Standard Wording, Assumptions and Provisions for Swaps – a document that essentially set out a common language for swaps. Was this always seen as a first step or was this the extent of the ambitions at the time?

JG: It certainly wasn't the end game, but we had to get people speaking a common language. Another law firm tried to standardise things first but put out a document that looked too much like one firm's documentation and it lost the mandate because of that. So, Dan Cunningham and I realised we had to get it looking so different that nobody could tell whether it was based on their document and to focus the group instead on getting a common vocabulary.

There was another important point that got people around the table in the early days and that was achieving legal certainty for these markets – we didn't want the courts deciding what the answer should be. So, we relied on the concept of 'liquidated damages' – of making sure that when the market reached a result, there would be no second guessing by the courts. We called that agreement value, then subsequently the term became market quotation. It was a form of alternative dispute resolution that sent people to dealers for answers rather than to courts, so the answers would come more quickly and be more commercial. And I think that appetite for legal innovation has characterised ISDA throughout its history. The common language we came up with in producing the code really equipped us to then contemplate a standard form agreement.

IQ: The Code of Standard Wording, Assumptions and Provisions for Swaps covered interest rate swaps, with currency swaps added in 1987 with publication of the Interest Rate and Currency Exchange Agreement. Why was the focus so narrow initially, and was there resistance to extending to other asset classes?

MB: There was external resistance from those who saw that swap teams were doing things they wanted to do but couldn't do as well. What was more intriguing to me was that there was some internal conflict on the ISDA board about whether we should expand beyond interest rate and currency swaps. We had a planning session in Naples, Florida, where a couple of us debated in front of the board whether we should extend our purview, and a distinguished English board member pointed out that if we didn't keep ourselves in check, there might come a day in the future when ISDA members would be managing the price risk of used cars. It might have troubled him that we would descend to that level. Nonetheless, the board chose to push out the frontiers, overcoming those challenges.

CJ: If you weren't willing to treat all asset classes as falling under the ISDA umbrella, there would be opportunities for various other trade associations. Netting was also an issue. The last thing you would want to do is truncate the document by asset class.

PSA: I don't know whether other firms had the same experience, but we were struggling within our own firms as well, because the FX department had a very different perspective. The equity guys also didn't want fixed income guys to have anything to do with equity swaps. So, the expansion of ISDA to different products was not simple because we had our own challenges internally.

JG: Nobody's mentioned the modular architecture of the ISDA Master Agreement, but, whether it was by luck or by vision, it played a huge part in reaching a result with these other desks. There was competition and there was defensiveness about moving away from what was familiar to something that was new. But we decentralised the documentation process and set up separate working groups with the expertise that was needed to deal with each market. People got familiar with the process of reaching a collective yes, which was really ISDA's magic – being able to get people who were otherwise competitors to buy into a process that reached consensus in the end. So, that decentralised process, which meant having different people in different rooms moving at a different pace to get to grips with a particular product covered by the documentation, really helped move things along.

IQ: The ISDA Master Agreement is product agnostic and allows all derivatives under a counterparty relationship to be netted. How important was this development?

MB: The capital savings that were achieved by having enforceable netting provisions in the ISDA Master Agreement were critically important to the success of the

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business. It just would not have been possible to capitalise all this activity if we did not have those enforceable netting provisions. We sat in the White House Rose Garden next to Federal Reserve officials as George HW Bush signed the first netting legislation into law.

CJ: The netting was critical, and it made ISDA's role very central once capital was imposed, because the ISDA netting opinions and later the collateral opinions became invaluable, and they are still one of the main reasons that ISDA continues to be so viable.

JG: When you ask the question is netting important, I keep thinking of that football coach who said 'winning isn't everything – it's the only thing'. I mentioned earlier the appetite for legal innovation if that's what it would take to move things to a better place. There were concepts that we could hardwire into the contract – things like single agreement theory and flawed asset theory. But if we thought it would make a positive difference, ISDA was prepared to roll up its sleeves and go on a world bankruptcy law tour to get law reform. In those early days, people said to us 'ISDA wants to amend bankruptcy laws in all these jurisdictions? Good luck. That's not going to happen in your lifetime. Those are the slowest areas of the law to revise.' But look at the map. Look at the list of countries that have since adopted legislation to ensure netting enforceability. That's not to be underestimated.

IQ: Carolyn, Rick – you served as the first two CEOs of ISDA in the 1990s. What were your ambitions for the association when you joined and what issues did you face?

CJ: My main mission when I started was to put the 'I' back in 'International'. I had a look at our membership, and we had lots of European and Asian members, but we only had an office in New York. That led to the opening of the London office, as well as the formation of the Southeast Asian group. The most memorable thing was the visits to Washington, DC. I used to go at least every week, and Mark would join me every couple of weeks, and we met with nearly every Congressional staff member to educate them about why derivatives are important. That helped set the ground for the legal certainty that came with the Commodity Futures Modernization Act of 2000 (CFMA).

RG: One of the first things I faced as CEO of ISDA was a concept release by the Commodity Futures Trading Commission in 1998. It asked several questions, but one of them was whether over-the-counter (OTC) derivatives are futures. Futures not listed on an exchange are unenforceable under the Commodity Exchange Act, so it raised a question about whether OTC derivatives were enforceable. This cast a shadow over the entire market. That required me to spend a lot of time in in Washington, DC with Mark and many others, meeting with members on the Hill and testifying multiple times in the House and Senate. Ultimately, Congress passed the CFMA, which was essential in ensuring the enforceability of OTC derivatives. Also, picking up on Carolyn's point about the international nature of the market, ISDA was very US focused when I joined, notwithstanding the opening of the London office. So, we built out the London office and opened offices in Tokyo and Singapore during my tenure, as well as strengthening the Southeast Asian members committee that Carolyn had formed and starting a Canadian members committee. Those were all important initiatives.

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Mark Brickell

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IQ: What's your fondest memory of being involved in derivatives markets?

GH: When I was at the World Bank, I had the luxury of speaking to the smartest guys on Wall Street. I knew I was participating at the beginning of something really big, which was driven by deregulation, innovation and globalisation, and it was really a thrilling time. I will also mention another time when I was on the sell side and I did my first $1 billion swap and it was done with a very quick exchange of 'oh yeah, done'. That was exciting in retrospect.

PSA: The high point was being asked by Dennis Weatherstone, then chief executive of JP Morgan, to co-chair a Group-of-30 report on derivatives with David Brunner of Paribas. The work was commissioned to demystify derivatives activity and to establish principles of sound risk management, which I think have endured the test of time. My greatest moment was me and David walking into Paul Volcker's office to negotiate the wording of a foreword that he graciously wrote for this report, which is a good read even today.

MB: I treasure the friendships made as part of this 40-year ISDA journey, and that working with all our colleagues, we've been able to achieve things that other people did not even conceive of, much less attempt.

RG: Three things really. It's been a privilege to meet and get to know and work with everybody I've met in the derivatives industry. It's been a terrific experience. Second, it was a great experience to be involved with a product that was brand new, exciting and was growing and is still growing. The third thing I most appreciate is that ISDA continues to thrive and grow today, and I hope that will continue for at least another 40 years.

CJ: My happiest moment was being asked to head up the trading desk for the first time for the Chase Manhattan Bank and to be involved in the evolution of the interest rate swaps market.

JG: To echo what somebody clever once said, 'you're only as good as the company you keep'. And boy, I've kept some great company working with ISDA. But let me mention one real thrill. When Lord Briggs, a Justice of the Supreme Court of the UK, was Mr Justice Briggs, he decided one of the early Lehman cases. In his published decision, he said the ISDA Master Agreement is probably the most widely used contract in the world, and it's probably the most important standard form document in the financial world. When I first met Lord Briggs, I said to him 'I sleep with one of your decisions under my pillow', and he said 'why would you ever do that?'. I said, 'well, it's the one where you said that the ISDA Master Agreement is the most important contract in the financial world. It was my privilege to hold the pen when we wrote that agreement'. So that was a big thrill.

TJ: Obviously being first co-chair of ISDA with Athur Walther from Goldman Sachs was extraordinary and I never conceived that ISDA would be what it is today. I'm very proud of my small contribution to that. I agree completely on the friendships that we've all developed. Third, I was the one who came up with the idea of the first annual general meeting, and I'm glad to say that ISDA has continued that wonderful idea. They were fun in the early days and I'm sure they're fun today. Last, I'd like to recognise Dan Cunningham, who can't be with us. He was a dear friend and had a huge impact on this market. IQ