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Guest Editorial

Much ink has been spilt in discussing the extent to which risks generated by over-the-counter (OTC) derivatives were implicated in the global financial crisis (GFC). Subsequent inquiries into the causes of the crisis have focused on, amongst other things, the substantial exemption of these financial instruments from regulatory oversight and an apparent lack of awareness amongst both market actors and regulators about the extent of risk involved. Following the GFC, a narrative has now emerged in both the United States and the European Union which emphasises the significance of systemic risk, comprising the aggregate consequences arising from failure of transactions as opposed to the risk associated with particular transactions. To address systemic risk, new regimes focus both on increasing the transparency of OTC derivatives transactions and on the imposition of new regulatory requirements.

The articles in this issue address three significant themes in understanding contemporary regulation of OTC derivatives markets. First, they address the claim that the markets were unregulated through an examination of private regulation. Second, they further investigate the practices of private regulation in the sector, demonstrating a substantial (and growing) degree of interdependence with public actors. Third, whilst the market instruments and practices concerned are often characterised as complex and technical in nature, there is a common thread running through the articles. This thread suggests that the shape and content of the applicable regime, in both its public and private elements, inevitably involves a degree of political contestation over interests.

The articles in this issue contest the characterisation of the pre-crisis position of OTC derivatives as substantially unregulated, emphasising the role of trade associations, and in particular the International Swaps and Derivatives Association (ISDA), in setting regulatory norms governing transactions. The article by John Biggins and Colin Scott examines the regulatory role of ISDA beyond the production of the boilerplate terms providing for the standardisation of transactions. This extended role includes both the proactive interpretation of the agreements and seeking public legislation to address gaps in the scope of agreements in many jurisdictions. This regulatory activity is not wholly private in character, deploying as it does the legislative capacity of states where interpretations of pre-existing law do not appear to favour standard ISDA contract terms. That the regulatory space is already populated has implications for fresh efforts to regulate the sector and may limit the effectiveness of attempts to deeply re-examine accepted wisdoms which have built up over time. It is not simply a matter of displacing private transactions with tightly specified and transparently regulated instruments.

We have noted that the regulatory role of ISDA extends beyond standard setting, to include also various dimensions of implementation. Both standard setting and implementation dimensions are subject to a significant degree of contestation, and this political aspect applies to both public and private activity in the sector. The politics of implementation is exemplified by the institutions and procedures for determining whether a credit event has occurred so as to trigger payments under a credit default swap (CDS) transaction. A key doctrinal device facilitating such determinations is a reference to custom as an aid to understanding what the parties intended. Any prioritisation of custom in understanding financial transactions is likely to put the industry itself in the driving seat in determining the prevailing technical meaning attaching to key contractual provisions.

Anna Gelpern's and Mitu Gulati's analysis of sovereign CDS points to something of a vacuum in the interpretation of trigger events, because sovereign credit events have been very rare and because sovereign debt distress frequently presents as a gradual deterioration against the background of complex political bargaining, rather than a single liquidation event. For these reasons, the very existence of custom as traditionally defined may be in doubt in the sovereign debt context. The process for determining CDS triggering events, overseen by the ISDA Credit Derivatives Determinations Committees (DCs), is fraught in the sovereign CDS context. The ISDA DCs may pursue strict 'textualism' in an attempt to simultaneously meet the competing demands of industry and public regulators, but it is unclear whether this approach is sufficient to meet either of these objectives in the longer term. The Greek sovereign debt crisis has called into question the effectiveness of the DC process and, by extension, the economic function of sovereign CDS.

The article by Glenn Morgan considers the efforts by key actors in the OTC derivatives markets to defend the operation of the markets against the imposition of arrangements which will intrude upon the flexibility of the traditional bilateral model of determining and meeting obligations. He demonstrates that although regulators had a strong awareness of the risks of permitting the operation of a deregulated market in the 1990s, bargaining occurred which tended to legitimate a regime which was largely private in character. Following from the GFC, a central focus of reform is the introduction of central clearing party (CCP) arrangements to clear collateral associated with derivatives contracts. CCPs intermediate between the contracting parties and are able to absorb losses should one of the parties fail. It is argued that CCPs are likely to inhibit the conclusion of more complex forms of agreement and to reduce the efficiency that is associated with purely bilateral agreements. The widespread acceptance of the plan to require greater use of CCPs may partly be attributed to the power of CCP organisations, and in particular the exchanges, which will offer the new arrangements to press their interests in debates on future regulatory policy.

Thus, an apparently technical argument over what will offer the safest and most efficient basis for future transactions masks a number of political tradeoffs, as key actors bargain to maintain or enhance their positions within the regulatory regime. Morgan argues that the risk of regulatory arbitrage has caused both US and EU regulators to shape new regulation in such a way that banks will not be tempted to move their business to less regulated jurisdictions. It may be that the non-standard bilateral products will continue to be available to those seeking to hedge particular risks. Political imperatives are sometimes implicated in regulatory initiatives which are disproportionate or unnecessary to target identifiable problems, but which provide reassurance through their symbolic power.

Following the GFC, regulators and politicians have sought to identify and address causes of market instability, amongst them the practice of short-selling. Jennifer Payne's article directly addresses the critique of and regulatory response to short selling. She elaborates on both the short-term bans issued in many jurisdictions during the financial crisis, and subsequent initiatives which emphasise the less intrusive regulatory intervention of imposing disclosure requirements. This raises questions as to whether enhancing transparency provides an appropriate balance between the preservation of the benefits of short selling on the one hand and reducing the risks on the other. Payne makes robust arguments to the effect that excessively stringent regulation of short selling has not been justified and risks restricting some of the benefits of short selling, including the enhancement of liquidity in markets. It may, for example, be too transparent to require disclosure to the market, when disclosure to the regulator might be sufficient to address the problems.

Further articles in this issue address the development of a co-regulatory code for the clearing and settlement of securities transactions generally within the EU and EU policies to address gender equality in the boardroom. Pablo Iglesias-Rodríguez' article notes the relative neglect of barriers to the consolidation of a single market in securities within the EU created by diverse practices for clearance and settlement. The development of a Code of Conduct for Clearing and Settlement which he discusses is an example of transnational private regulation, initiated by what he refers to as networks of private regulators (NPRs), but with the involvement also of the European Commission. Whilst he notes the practical benefits of having such a European code as an instrument of harmonisation, the main thrust of his analysis is concerned with assessing the legitimacy of such a private instrument, which sources from a 'factual indirect delegation' by the European Commission to the NPRs. The framework for assessing the legitimacy of the Code is supplied by Fritz Scharpf's work, which contrasts legitimacy derived from processes (input legitimacy) from that derived from the effects of the activity (output legitimacy). This assessment, together with an analysis of how deficiencies in legitimacy might be addressed, is made in the context of the potential for further legislative initiatives from the European Commission and regulatory initiatives from the European Securities and Markets Authority (ESMA).

Karolien Pieters addresses new policy initiatives targeted at gender inequality in corporate governance in the EU. The context for the analysis is the very poor representation of women on company boards in the EU, with fewer than ten per cent of directors of the largest companies being women. However, this statistic hides considerable variation amongst the Member States, with Sweden and Finland each showing more than 25 per cent of directorships held by women. Pieters notes that this variation is affected partly by the introduction of gender quotas for company boards in some Member States, on both voluntary and compulsory bases. She argues that the imposition of quotas at EU level is likely to be counterproductive and suggests instead that more fundamental changes to family policies offer a better route to address the gender inequality issues involved. She suggests that companies must also be involved in developing policies which support participation of women at the highest level and she highlights a number of positive examples. The EU role in such bottom-up governmental and corporate initiatives should, she suggests, be more as coordinator than mandator. This issue concludes with a review by Emilios Avgouleas of Niamh Moloney's book *How to Protect Investors: Lessons from the EC and the UK* (2010).

The articles in this issue address key issues concerning corporate governance and the future regulation of financial markets. They reflect upon gender equality in the corporate context; the balance between bilateral and multilateral regulatory arrangements; the balance between public and private regulation; the relationship between procedural and substantive legitimacy; and between regulatory approaches premised on enhancing transparency on the one hand and more interventionist strategies on the other. These are not simply technical matters of regulatory policy since the choices made are the subject of intense lobbying as EU and US reforms are implemented. The outcomes are likely to fundamentally affect both the efficiency and robustness of financial markets in years to come.

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