10 Questions with...

Darcy Bradbury

Darcy Bradbury, an ISDA board member and managing director at the D. E. Shaw group, talks about the changes that have occurred to the derivatives market, the impact of initial margin requirements and the importance of an appropriately calibrated rule set

IQ: Can you tell us about your role at the D. E. Shaw group?

Darcy Bradbury (DB): I joined the firm 11 years ago, and my role has evolved over that time, but it has always focused on public policy issues. Today, I split my time between regulatory policy, both analysing policies and advocating through trade associations like ISDA, and government policies that might impact our investment portfolios, which involves analysing issues with our investment strategists. Public policy today is in a period of great debate and change around the world and across many issues, so it can have a bigger-than-usual impact on our firm and our investors' portfolios.

IQ: How and why does the D. E. Shaw group use derivatives for its clients?

DB: Our firm uses derivatives both to invest and to hedge risks in our funds. Derivatives can be an efficient way to implement many investment ideas given their low transaction costs and ease of customisation. In addition, derivatives are a key risk management tool for those of our strategies that endeavour to hedge general market risks that aren't central to our investment theses.

IQ: What do you see as the current main priorities for derivatives market participants?

DB: All firms that use swaps have been coping with an unusual level of change over the past six years, so I think many of us would like a breather – some time to reflect on what's working well and what needs to be refined. There have been changes in regulations, technology and margin requirements, all of which have required time and effort to analyse and implement.

We have worked to create new contractual relationships with clearing houses, swap execution facilities (SEFs) and new dealers, but have benefited from access to central clearing, which has reduced our bilateral counterparty risks. We've seen the universe of clearing brokers shrink, likely due to new capital rules, but we've also been able to find new trading counterparties thanks to electronic trading on SEFs. We've had to make changes to our trading and compliance systems to enable us to trade effectively and carry out compliance and reporting obligations in these new regimes. Overall, the swaps market functions as well or better in many aspects than it did before all the changes, but I'm optimistic that policy-makers are now willing to recalibrate certain rules in light of our collective experience and better data about the derivatives markets.

IQ: Initial margin (IM) requirements for non-cleared derivatives transactions are set to be extended to a much broader range of derivatives users in 2019 and 2020. What are the implications of this?

DB: There are different implications, depending on whether a firm already posts IM for swaps it can't clear. Many buy-side firms have not had to post IM, so this change means not only significant operational changes, but also a direct increase in costs. Our funds have been posting IM for decades, so while there are operational hurdles, our main concern is how the new IM levels will be set.

When the margin rules were drawn up more than five years ago, regulators seem to have assumed that all non-cleared swaps were riskier than cleared swaps and they needed to push firms into central clearing, so margin was based on a standard 10-day liquidation period versus five days for cleared swaps. While most of our non-cleared swaps are customised or otherwise not eligible for clearing, the reference assets are often quite liquid – for example, equities, rates or commodities – so if there were ever a problem, our counterparties would presumably be able to hedge their risk or liquidate readily. Dealers currently require us to post IM based on more sophisticated analyses of the underlying reference assets and our credit risk – an approach we think has protected them and the financial system as a whole quite effectively over the years.

IQ: Will the derivatives market look different in three years' time? In what way?

DB: In some respects, no. There will continue to be a need for derivatives from a wide variety of firms to hedge their risk or optimise their investment profiles. Having said that, there are some big changes on the horizon; benchmark reform is one. Regulators globally have directed the markets to find alternative reference rates to LIBOR and the other IBORs. Given the extensive use of these benchmarks in contracts across financial markets, this will require unprecedented industry effort and resources over the next three years. It's not something any of us can ignore.

Margin is another. Beginning September 2020, regulations will require a much larger universe of small banks and financial end users to post IM and use a standardised calculation method. This will change how these firms trade derivatives – both from a systems perspective and also in terms of cost. Those changes will be extremely burdensome for many.

IQ: Will technology fundamentally change derivatives markets?

DB: Our firm was built 30 years ago at the intersection of technology and finance, so we fully believe in the value of using the power of technology to make better investment decisions and reduce inefficiencies. ISDA's work to develop a set of digital standards for events and processes through the Common Domain Model is an important step to realising the full potential of new technologies like distributed ledger, which could improve operations and reduce errors.

IQ: How do you view ISDA's role in the market?

DB: ISDA is a wonderful convener of constructive conversations and a builder of effective solutions. The derivatives market is complex and global and includes participants with different business goals and models. From its roots as a dealer-centric organisation, ISDA has evolved into a diverse, member-driven entity where we can share ideas, build common solutions and advocate for sound policy based on data.

IQ: What ISDA initiatives are most important from your perspective?

DB: ISDA has been a long-time advocate for cross-border harmonisation, which is critical for the efficient functioning of the derivatives market. The markets need to increase the degree of harmonisation across borders and among national regulators to reduce duplicative compliance costs and promote global liquidity. ISDA's focus on margin for non-cleared derivatives has also been important, including the development of the ISDA Standard Initial Margin Model. In addition, ISDA is playing an extremely important role in raising awareness of benchmark reform in order to help ensure a smooth and orderly transition from the IBORs to alternative risk-free rates.

IQ: What are your hobbies?

DB: I'm deeply involved with two organisations that work to reduce poverty, improve reproductive health and increase educational opportunities, with a particular focus on women, girls and immigrants. To recharge, I spend as much time in my garden as possible. Pruning roses is a great way to free the mind.

IQ: If you could live and work in any financial centre other than New York, what would it be – and why?

DB: Not going to happen. I love to travel, but there's no place like New York City for art, food, music and finance. IQ