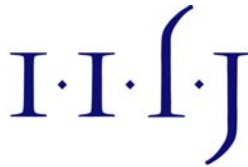

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ACCOUNTABILITY IN TRANSNATIONAL CONTRACTUAL GOVERNANCE: THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION

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Accountability in Transnational Contractual Governance: The International Swaps and Derivatives Association[*]

Maciej Borowicz[†]

This paper uses the Global Administrative Law (GAL) approach to develop a model of accountability in transnational contractual governance (TCG). In the transnational context contracts are increasingly governed not only by contract law but also by elaborate regimes of private ordering. Derivatives contracts, for example, are governed by the rules developed by the International Swaps and Derivatives Association (ISDA). The fact that these rules of contract governance are set, monitored, and to a certain extent enforced by a body which is not accountable to the public – at least not in a way that national legislators and judiciaries are – *prima facie* undermines the legitimacy of contracts used in derivatives markets. This is true in particular because of the negative externalities that these contracts are prone to generate. In an attempt to provide an alternative model of accountability this paper argues that accountability of ISDA is better understood as a combination of procedural GAL-like standards applicable to ISDA itself as well as legislative and judicial recognition of the regulatory standards contained in the documentation developed by ISDA, and in particular the ISDA master agreement (MA). This model of accountability makes TCG responsive to both cosmopolitan and national constituencies, strengthening the argument for conceptualization of GAL as a pluralist legal order.

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[*] This paper has benefited tremendously from comments made by Megan Donaldson (NYU). These comments concerned both matters of substance and style. All mistakes that remain are my own. maciej.borowicz@eui.eu.
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1. Introduction

Contracts are primarily governed at the level of contract law.[1] Contract law, in other words, provides 'the rules of the game.' The goal of the game is simple: it is "to craft order, mitigate conflict and realize mutual gains."[2] Contract law rules have been crafted instrumentally to achieve these goals. They are complex and they reflect years of socio-economical and political struggles that informed their development.[3] These rules have been established, modified and enforced by bodies such as national legislators and judiciaries, which, few would dispute, generally enjoy a degree of political legitimacy.[4] Accountability is a measure of a certain type of legitimacy, one that testifies to the 'responsiveness' of a regime to a relevant public, i.e. ideally the public that could be affected by activities under the regime.[5] It is in virtue of the accountability of national legislators and judiciaries that contracts governed by contract law rules are deemed to be a legitimate exercise of power.[6]

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[1] Oliver E. Williamson, *New Institutional Economics: Taking Stock, Looking Ahead*, XXXVIII J. OF ECON. LIT. 595–613 (September 2000). Williamson discusses governance as one of four levels of institutional analysis. The first level is that of social embeddedness. Here informal institutions, customs and traditions are located. Institutions at this level change very slowly. Social theory analyses this level. The second level is that of the institutional environment. It includes formal rules such as those contained in constitutions and law. Importantly, at this level, property rights are defined and enforced. Prescriptions concerning the institutional environment are made in particular in the economics of property rights literature and in positive political theory. The third level is that of governance properly so-called. It goes beyond the rules of the game (property) to include the play of the game (contract). Here the governance of contractual relations becomes the central focus. Transaction costs economics employs a transaction as the central unit of analysis. Finally, the fourth level is that of neoclassical analysis/agency theory. Here issues of resources allocation and employment are discussed. *Id.* at 597-600.

[2] *Id.* at 599 (referring to John R. Commons, *The Problems of Correlating Law, Economics and Ethics*, WISC.LAW REV. 8:1, pp. 3–26.)

[3] *Compare* Peer Zumbansen, *Law After the Welfare State: Formalism, Functionalism and the Ironic Turn of Reflexive Law*, 56 AMER J. COMPAR. L. 796-805 (2008) ("Contract law . . . represents a regulatory regime that is constituted and shaped by an ambiguous relationship between "state" and "society" in the institutional evolution from the Rule of law to the welfare state."). Id. at 803.

[4] The notion of legitimacy is of course a multi-faceted one. When applied to governance regimes, it is usefully understood with reference to "the nature and extent of acceptance that institutional arrangements and normative choices, from among the possible configurations, are more or less right for the time being."[4] Jan Aart Scholte, *Towards Greater Legitimacy in Global Governance* 18 REV. INT'L POL. ECON. 110, 112 (2011).

[5] *See e.g.* Ronald J. Oakerson, "Governance Structures for Enhancing Accountability and Responsiveness", in J.L. PERRY (ed.) HANDBOOK OF PUBLIC ADMINISTRATION (1989), 114 at 114 [*hereinafter* Oakerson, "Governance Structures"] ("[t]o be accountable means to have to answer for one's action or inaction, and depending on the answer, to be exposed to potential sanctions, both positive and negative.").

[6] "Because B is bigger than A, B enjoys a power advantage in the exchange relation between them. Or because A is dependent on 6, 6 has a power advantage over A. Or if A and B were initially on a parity, but a disturbance has occurred that works in B's favor, then parity is upset and B now has more power." Oliver E. *Williamson, Hierarchies, Markets and Power in the Economy: an Economic Perspective*, 4 INDUSTRIAL AND CORPORATE CHANGE 1, 21-49 (1995) (arguing that power has little to contribute to the study of contract and organization in circumstances where the parties to an exchange can and do contract in a relatively farsighted way and since that varies with the circumstances, power has relatively less to offer to the study of capital and intermediate product markets, has more bearing on labor and final product markets). For a sociological account of power *see e.g.* PETER M. BLAU, EXCHANGE AND POWER IN SOCIAL LIFE (1964) at 7 ("Processes of social attraction, without which associations among men would not occur, give rise to processes of exchange. Unreciprocated exchange leads to the differentiation of power. The exercise of power in collectivities, as judged by social norms of justice, promotes processes of social approval, legitimation, and organization, on the one hand, and forces of opposition, conflict, reorganization, and change on the other."). Of course contracts that are deemed to be a legitimate exercise of power under contract law can be found to be illegitimate under another legal regime, such

Contracts are also governed at the level of private ordering.[7] This is to say that private ordering also provides 'rules of the game,' most of the time in a complementary fashion to contract law.[8] These rules, as opposed to the rules of contract law, have not been established by bodies that *prima facie* enjoy the quality of legitimacy, and have the accountability, that attaches to public bodies in the national context. This is because, as private transnational bodies, they have difficulty identifying the relevant public to which they could and should be accountable. This, at least *prima facie*, bears negatively on the legitimacy of the contracts governed by those rules, and the exercise of power made possible by those contracts.

Consider derivatives. Derivatives are, in essence, financial contracts that facilitate the trading and redistribution of risk. They owe their name to the fact that their value is derived from an underlying asset, index or another reference value. Since they redistribute risk, they can be used either to insure (hedge) oneself against a particular risk or, conversely, to take on risk (invest or speculate).[9] They can also be used to arbitrage between different markets.[10]

The ISDA Master Agreement (MA) is a contract commonly used to govern derivatives contracts. It defines a number of standards that ultimately perform a regulatory function.[11] It has been developed by the International Swaps and Derivatives Association

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as that of antitrust law for example. For an examination of the interplay between contract law and antitrust law in "legitimation" of contracts see in particular Mark R. Patterson, *Standardization of Standard-Form Contracts: Competition and Contract Implications*, 52 WILLIAM AND MARY LAW REVIEW 2, 327-414, 334 (2010).

7 Compare Steven L. Schwarcz, *Private Ordering*, 97 NORTHWEST. U. L. REV. 319-350 (2002). See also Barack D. Richman, *Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering*, 104 COL. L. REV. 8 (2004). On the role of private ordering in the transnational context see in particular Fabrizio Cafaggi, *New Foundations of Transnational Private Regulation*, 38 J. L. & SOC. 1 (2011).

8 In some cases it does so in an alternative, rather than a complementary fashion. *See e.g.* Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001). *See also* Barack D. Richman, *How Community Institutions Create Economic Advantage: Jewish Diamond Merchants in New York*, 31 L.& SOC. INQ. 2 (Spring 2006).

9 Speculation has always been at the heart of much of financial activity. It is in fact argued that it might be necessary for the operation of liquid and efficient markets. "Without speculation, markets would be less complete in that there would be fewer opportunities for other market participants, especially hedgers, wishing to manage the risks they encounter in their financial activities." See e.g. David Mengle, "The Economic Role of Speculation", ISDA Research Notes (Issue 2, 2010). But of course there excessive speculation can harm the economy. *See e.g.* J.M. KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 159 (1936) ("Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill done.").

10 *See* Impact Assessment, Commission staff working document accompanying a proposal for regulation of derivatives, central counterparties and trade repositories, SEC(2010) 1058/2, available at http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_impact-_assessment_en.pdf (last visited November 17, 2012).

11 *See* Jongho Kim, *From Vanilla Swaps to Exotic Credit Derivatives: How to Approach the Interpretation of Credit Events*, 13 FORDHAM J. CORP. & FIN. L. 705-804, 752 (2008) ("The International Swaps and Derivatives Association's efforts to standardize swap agreements have been integral in advancing the use of credit derivatives instruments, particularly in the areas of standardization of interest and currency swaps. Above all, ISDA contributed greatly to preventing disputes and reducing transaction costs by standardizing the swap agreement."). *See also* Colleen M. Baker, Regulating the Invisible: The Case of the Over-the-Counter Derivatives, 85 NOTRE DAME L. REV. 4, 1287-1378, 1358-59 (2010) (private international institutions (private actors) such as ISDA can facilitate cooperative global regulatory structures otherwise highly problematic for government actors because of transaction costs. ISDA, a global private actor, has arguably implicitly begun this

(ISDA). ISDA is said to have emerged from discussions in New York in the early 1980s, led by Salomon Brothers – an investment bank – and other entities that were beginning to sell derivatives (particularly swaps[12]).[13] This group then employed the US law firm Cravath as well as the London firm Allen & Overy to advise them on how to proceed. Over the following years the ISDA was formed. It has grown considerably and has by now become the most influential organization shaping the rules of the derivatives market.

Interestingly, despite its prominence, ISDA was little known to people outside of the financial industry, at least before 2008. Shortly after the collapse of Lehman Brothers (LB), however, the very word 'ISDA' not only became a somewhat toxic one in Washington and Brussels' political circles,[14] and made headlines, but also attracted greater attention in legal scholarship.[15] The "discovery" of ISDA at that time can be, at least in part, attributed to the fact that derivatives, including those governed by ISDA's MA, have been linked to some of the negative externalities that arose as a consequence of the collapse or near-collapse of the so-called "systematically important institutions" during the early days of the global financial crisis, including LB. At the same time, a number of commentators have argued that the MA actually helped to mitigate the effects of the failures or near-failures of these institutions.[16] There might be little consensus as to whether the MA affects systemic risk in a predominantly positive (mitigating) or negative (compounding) way. What is certain, however, is that it can affect it. What at first sight looks like a bilateral contract can potentially affect parties outside of the contractual relationship, and perhaps even the financial system as a whole.[17]

The recognition of this potential effect has led regulators on both sides of the Atlantic to supplement general contract law rules that are said to govern derivatives, with rules that impose certain reporting and clearing obligations.[18] In their own right these

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task by its creation of a global private law for over the counter (OTC) derivatives, self-help mechanisms, and increasingly, adjudicatory mechanisms).

[12] A swap is the most basic, or "vanilla" type of forward claim that is traded in the OTC market between two private parties, usually firms or financial institutions.

[13] For a discussion of the evolution of ISDA *see e.g.* Sean M. Flanagan, *The Rise of a Trade Association: Group Interactions Within the International Swaps and Derivatives Association*, 6 HARV. NEGOT. L. REV. 211, 240 (2001) [hereinafter Flanagan, *The Rise of a Trade Association* (2001)]

[14] *Cf.* Gillian Tett, Calls for radical rethink of derivatives body, Financial Times (August 26, 2010).

[15] A Westlaw search of the LAWREV-PRO database with the keywords "isda /p derivatives" returned over 300 results on November 17, 2012.

[16] ISDA's representatives estimate that ISDA's documentation has governed both the settlement of credit default swaps as well as the liquidation of perhaps 1m derivative contracts of defaulting counterparties during the period of financial stress of the late 2000s. See Letter from Mr. Conrad P. Voldstad, "Working hard to make markets safer", Financial Times, September 2, 2010.

[17] *Cf.* David A. Skeel and Thomas *H. Jackson, Transaction Consistency and the New Finance in Bankruptcy*, 112 COLUM. L. REV. 152 (2012) (for a discussion of how derivatives- and repos- related bankruptcy provisions have "tested" the "systemic" justification behind some of those provisions).

[18] Recent financial reform legislation in Europe and in the US requires most of those trades to be "cleared" by a centralized counterparty, thereby altering the nature and structure of OTC trades. In the U.S. the Dodd-Frank Wall Street Reform and Consumer Protection Act brought comprehensive reform to the regulation of swaps. In the European Union the European Market Infrastructure Regulation (Emir) (enacted in March 2012, and published in the Official Journal of the EU on July 27, 2012) requires that OTC derivatives be cleared through clearing houses to help safeguard the system against future big defaults like that of LB. It also requires that derivatives trades be reported to trade repositories, to provide regulators with an audit trail of transactions. See Regulation No 648/2012 of the European Parliament and the Council on OTC derivatives, central counterparties and trade repositories. OJ L 201/1 (July 27, 2012).

reforms address only a part of the governance regime for derivatives – contract law. On a number of occasions courts have applied contract law rules to the MA.[19] In other cases however, contract law has been trumped, for example, by bankruptcy law,[20] which ISDA as an organization has 'helped' to shape in a way that makes sure that derivatives are basically 'paid first.' Moreover, most derivatives-related disputes never make it to courts and are settled either between the parties, or through ISDA's committees and settlement mechanisms. Therefore it is safe to say that the derivatives are governed not only by national contract law, but also through various private ordering mechanisms provided by ISDA. The regulatory reforms instituted by the Dodd-Frank Act in the US and the EmiR Regulation in the European Union correctly address the problem of effectiveness of the governance regime of derivatives, but they do not address the issue of its accountability.

It can be suggested that the accountability dimension is missing because there exists a gap, a theoretical gap, in our thinking about accountability in TCG. This gap can be attributed, in particular, to the inability of decision makers (legislators, judges) to address the issue of accountability through means of contract law. In classical contract law the question of accountability as such does not arise. Contracts can be used as instruments of power – classical contract law scholars would acknowledge – but the relevant question is how that power can be constrained in the relation between the parties, and not how to make the persons responsible for its exercise more accountable to a larger public. Arguably, there is a lot of room in contract law to incorporate such considerations[21], but currently there exists no theory that would provide a systematic account of how this could be done.[22]

This gap in our theories of accountability is the starting point for this paper. It will be argued here that this gap is problematic from a normative standpoint, because the failure to develop conceptualizations of accountability and legitimacy in governance of contracts through private ordering limits our ability to understand how outcomes are produced and how actors are differentially enabled and constrained in global governance. The question thus arises: how to address this dimension of the governance of contractual relations?

This paper uses the GAL approach to develop a model of accountability in TCG. It first outlines the nature of the power exercised by ISDA in the broader context of derivatives regulation (section 2), and argues why GAL may be well suited to inform a model of accountability in TCG (section 3). This is primarily because of its emphasis on principles of transparency, rationality and legality and effective review of the decisions that are made in global governance. At the same time to emphasize the role of GAL in endowing TCG with

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[19] *See e.g.* Fin. One Pub. Co. v. Lehman Bros. Special Fin., Inc., 414 F.3d 325, 338-40 (2d Cir. 2005) (analyzing claims arising under derivatives contracts using state contract law without reference to laws governing specialized financial instruments).

[20] In re Lehman Brothers Holdings, Inc., Case No. 08-13555 et seq. (JMP) (jointly administered) (this case is discussed in more detail in section 4 of this paper).

[21] *Compare e.g.* Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283, 284 (1995) (noting that externalities are an important factor in courts' decision to refuse to enforce contracts). The antitrust law perspective, which would also seem to be a candidate for performing the task of imposing limits on the exercise of power through contracts, is also somewhat helpless vis-à-vis the issue of accountability for the exercise of power in TCG. Firstly, it is primarily interested in the contracts and not the bigger picture of governance and secondly, it asks a very particular set of questions concerning anticompetitive effects of contracts, which may be relevant from the point of view of legitimacy and public policy, but are different from the questions concerning accountability.

[22] *But see* HUGH COLLINS, THE LAW OF CONTRACT (2003).

accountability is not to disregard the role that contract can play in that regard. Rather, it can be suggested that GAL, because of the procedural nature of its normative outlook is well suited to *complement* the regulatory function of contract law, which, in its very nature, is more substantive. Section 3 describes ISDA's role in derivatives markets and a number of the organization's features that could be an obstacle to GAL-like accountability. At the same time, it is suggested that ISDA has successfully tackled many, even if not all, of those obstacles, by trying to become much more inclusive and transparent, but also seeking to have its documentation recognized in various jurisdictions. Overall, without prejudice to the substantive effects that ISDA had on TCG in derivatives markets in the years leading up to the 2008 financial crisis and beyond, ISDA can be said to exemplify a model of accountability in TCG. This model consists of a combination of procedural GAL-like standards applicable to ISDA itself as well as legislative and judicial recognition of the regulatory standards contained in the documentation developed by ISDA, and in particular the ISDA MA. This model of accountability makes TCG responsive to both cosmopolitan and national constituencies, strengthening the argument for conceptualization of GAL as a pluralist legal order, and it can also be used in conceptualizing accountability of public bodies.

2. ISDA: A power analysis

It is perhaps the cornerstone feature of every legal system that it legitimates the exercise of power. Accountability is one dimension of that legitimation, one that makes those who exercise power responsive towards those against whom power is exercised. But power is not always easily recognized. When the US Congress enacts a massive piece of legislation such as the Dodd-Frank Act, the source, but also the limits, of its power are clear. The source, the limits and, for that matter, the nature of power of organizations like ISDA is much less straightforward. As Horatia Muir Watt recently noted in her criticism of classical approaches in public and private international law:

> "[t]he most spectacular convergence of denials by public and private international law concerns the forms of private power exercised in the global economy by non-sovereign entities such as multinational corporations or rating agencies. In spite of their significant role in shaping of the global market, these entities escape any credible form of public accountability or private responsibility."[23]

This is problematic – suggests Muir Watt – because as long as private power is not recognized it cannot be made subject to adequate treatment under the law.[24] The relative incapability of contract law to address the issue of accountability of regimes of TCG discussed in the introduction to this paper can be primarily attributed to our poor understanding of how power, and in particular private power, operates in the transnational context. This section tries to enrich our understanding of the different ways in which power

[23] Horatia Muir Watt, *Private International Law Beyond the Schism*, IILJ Working Paper 2012/1 (referring to, inter alia, A. CLAIRE CUTLER, PRIVATE POWER AND GLOBAL AUTHORITY: TRANSNATIONAL MERCHANT LAW IN THE GLOBAL POLITICAL ECONOMY 14 (2003) and Dan Danielsen, *How Corporations Govern: Taking Corporate Power Seriously in Transnational Regulation and Governance*, 46 HARVARD JOURNAL OF INTERNATIONAL LAW 2, 411-425 (2005)).

[24] *Id.*

operates in TCG, relying on the contributions of literature in political science.[25] The analysis will focus on the role of ISDA in the governance of derivatives markets.

ISDA is the largest global financial industry association. As of October 2012 it had over 840 members from 59 countries on six continents.[26] These members include most of the world's major institutions that deal in privately negotiated derivatives,[27] as well as many of the businesses, governmental entities, investment managers and other end users that rely on OTC derivatives to manage the financial market risks inherent in their core economic activities.

ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business. The mission statement of ISDA identifies the organization's role as, inter alia, representing all market participants globally, promoting high standards of commercial conduct and leading industry action on derivatives issues. With these goals in mind ISDA provides standardized documentation globally to ensure legal certainty and minimize risk through netting and collateralization; promotes infrastructure that supports an orderly and reliable marketplace, as well as transparency to regulators; enhances counterparty and market risk practice; advances the effective use of central clearing facilities and trade repositories; and represents the derivatives industry through public policy, ISDA governance, ISDA services, education and communication.[28]

As Kingsbury et al suggest, in national law, private bodies such as ISDA are typically treated as clubs rather than as administrators, unless they exercise public power by explicit delegation.[29] "But in the global sphere, due to the lack of international public institutions, they often have greater power and importance. Their acts may not be much different in kind from many non-binding intergovernmental public norms, and may often be more effective."[30]

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[25] I rely in particular on Michael Barnett and Raymond Duvall, *Power in International Politics*, 59 INT'L ORG. 1, 39-75 (2005) [*hereinafter* Barnett and Duvall, *Power*].

[26] http://www2.isda.org/about-isda/ (last visited November 5, 2012).

[27] A large portion of derivatives has been traditionally traded in the over-the-counter (OTC) markets, i.e. directly between two parties, without going through an exchange or other intermediary. Alternatively, derivatives can also be traded on exchanges.

[28] http://www2.isda.org/about-isda/mission-statement/ (last accessed November 5, 2012).

[29]Benedict Kingsbury, Nico Krisch & Richard Stewart, *The Emergence of Global Administrative Law*, 68 L. & CONTEMP. PROBS. 15, 23 (2005) [*hereinafter* Kingsbury et al, *The Emergence*]. These organizations often constitute what Hugh Collins calls 'club markets.' "A club market is created by a group of traders for their mutual protection and to obtain efficiency gains through savings on transaction costs . . . The advantage of a club market is that it permits the expansion of membership of the trusted group and at the same time increases the potential severity of non-legal sanctions. The rudimentary form of a club market is that the members agree to be bound by the rules of the association." HUGH COLLINS, REGULATING CONTRACTS 212 (1999). As Collins notes, 'club markets' were instrumental in creating derivatives, in particular futures markets. "The club market can supply three essential ingredients for a futures market: first, a standardized, mandatory style of commodity description; secondly, a standardized mandatory contractual package of terms or entitlements; and third, a mechanism for creating an irrevocable and unimpeachable obligation." *Id.* at 213. To the extent that these private actors operate on the basis of delegation it has been argued that the existing administrative structures are ill suited to oversee the sound exercise of judgment and discretion. *See in particular* Kenneth A. Bamberger, *Regulation as Delegation: Private Firms, Decisionmaking and Accountability in the Administrative State*, 56 DUKE L. J. 2, 377 (2005). *Compare also* MARTHA MINOW, JODY FREEMAN (EDS.), GOVERNMENT BY CONTRACT: OUTSOURCING AND AMERICAN DEMOCRACY (2009).

[30] Kingsbury et al., *The Emergence*, supra note 1 at 23.

ISDA, for example, has developed highly effective and rapid 'legislative' reform processes through its protocols, self-help mechanisms through its collateral practices, and increasingly – in response to the crisis – global adjudicative mechanisms through Credit Derivative Determination Committees. In that regard, as Colleen Baker observed, as a global private actor, it has replicated in varying degrees the basic jurisdictional powers (prescriptive, adjudicatory, enforcement) of government actors.[31] It is fair to say that ISDA is more than just an industry trade association. "It performs a very important private law making and governance function in the OTC derivative markets."[32] There can also be little doubt that the governance rules it prescribes have important distributive consequences. Just ask the Greeks.

In 2009, after fifteen consecutive years of economic growth, Greece entered recession. By the end of 2009, the Greek economy faced the highest budget deficit and government debt to GDP ratios in the EU. The 2009 budget deficit stood at 15.4% of GDP. This, and rising debt levels (127% of GDP in 2009), led to rising borrowing costs, resulting in a severe economic crisis.[33] It is hardly surprising that under these circumstances many investors and banks that purchased Greek sovereign bonds also purchased Greek sovereign credit default swaps (CDS) to protect themselves against the risk of default. These CDS, many entered into pursuant the ISDA MA, are not unlike insurance contracts. In a CDS, the buyer of protection pays a fee to obtain indemnification against the risk of default of a borrower (for example, Greece), and any resultant loss, from a protection seller. Payment is triggered by a "credit event", technically defined as failure to pay interest or principal, debt moratorium or repudiation or restructuring. But around mid 2012 there was a lot of uncertainty among Greek CDS holders concerning what "restructuring" really means. The pressing question at the time was whether voluntary restructuring – entailing lenders agreeing to Greece exchanging existing bonds and loans for ones with different terms (longer maturity, different rates) – could be considered a credit event under the CDS.[34]

On March 9th, 2012 the European, Middle Eastern and African section of the Credit Determination Committees (DCs) announced that a restructuring event had occurred with respect to Greece.[35] As one commentator for the FT remarked: "while perfectly legal, the

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[31] Baker, *Regulating the Invisible*, *supra* note 10 at 1360.
[32] *Id.*
[33] http://ec.europa.eu/economy_finance/eu/countries/greece_en.html last visited November 5, 2012).
[34] Gretchen Morgenson, "Scare Tactics in Greece", NY TIMES (November 19, 2011), available at http://www.nytimes.com/2011/11/20/business/credit-default-swaps-as-a-scare-tactic-in-greece.html (last visited on November 5).
[35] See ISDA (Press release), ISDA EMEA Determinations Committee Accepts Question Related to a Potential Hellenic Republic (Greece) Credit Event (March 9th, 2012) available at http://www2.isda.org/asset-classes/credit-derivatives/greek-sovereign-cds/ (last visited November 5, 2012). The Determinations Committee held that the invoking of the collective action clauses by Greece to force all holders to accept the exchange offer for existing Greek debt constituted a credit event under the 2003 ISDA Credit Derivatives Definitions. Those Definitions state that the Restructuring Credit Event is triggered if one of a defined list of events occurs, with respect to a debt obligation such as a bond or a loan, as a result of a decline in creditworthiness or financial condition of the reference entity. The listed events are: reduction in the rate of interest or amount of principal payable (which would include a "haircut"); deferral of payment of interest or principal (which would include an extension of maturity of an outstanding obligation); subordination of the obligation; and change in the currency of payment to a currency that is not legal tender in a G7 country or a AAA-rated OECD country. An important element of the definition of Restructuring is that the event has to occur in a form that binds all holders of the "restructured" debt. The DC found that the Greek debt restructuring plan involves a "haircut" and is binding on all holders of Greek debt. ISDA (Press release), Greek

ability of a private body of financiers and lawyers to determine whether or not there has been "default" is unusual and legally untested."[36] This is a rather genteel way of saying something about ISDA's, or more specifically, the DC's perceived legitimacy. The DCs comprise ISDA members who, in essence, have the biggest positions in any CDS contract under examination.[37] As such they are not independent bodies, neither institutionally nor in terms of the rules that they are bound to apply.[38] The identity of each current (and past)

Sovereign CDS Credit Event Frequently Asked Questions (FAQ) (March 9th, 2012) available at http://www2.isda.org/asset-classes/credit-derivatives/greek-sovereign-cds/ (last visited November 5, 2012).

[36] Satyajit Das, "Final arbiter in Greek saga is untested, private body", FT.com (June 22, 2011), available at http://www.ft.com/intl/cms/s/0/95e3131a-9bf9-11e0-bef9-00144feabdc0.html#axzz2BMvE6lyE (last visited November 5, 2012). See also Morgenson, "Scare Tactics," supra note 37 (illustrating the conflicts of interests inherent in the activity of the DCs – "One of the money managers who attended the meetings said Ms. Yang's presence seemed to raise a conflict. Ms. Yang works for BNP, which stands to profit from the restructuring. She is also on the I.S.D.A. panel, which will determine if credit default swaps pay off. One of the money managers said he pointed out Ms. Yang's dual role at a meeting. "You're on the determinations committee, your firm is earning a big fee and trying to scare me into tendering my bonds," he said he told her. He said Ms. Yang replied: "No, I'm just trying to help tell you what could go wrong.").

[37] As to sell side: "There are separate criteria for membership on a DC depending on whether the member is a dealer or buy side member. To become a dealer member, the dealer institution must fulfill three requirements. First, the dealer must be a participating bidder in auctions. Second, the dealer must adhere to the "Big Bang" protocol. Last, the composition of dealer members will be based upon notional trade volumes as reported by Depository Trust and Clearing Corporation (DTCC) data via their Trade Information Warehouse (TIW)." The CDS Big Bang: Understanding the Changes to the Global CDS Contract and North American Conventions, Market (March 13, 2009), available at http://www.markit.com/cds/announcements/resource/cds_big_bang.pdf. As to buy-side: "To become a buy side member of a determination committee is a two-tier process. Buy side members of a DC will be randomly selected from a buy side pool. To qualify to be in the buy side pool, the institution must have at least $1 billion in assets under management (or the equivalent), have single name CDS trade exposure of at least $1 billion, and be approved by one-third (1/3) of the then-current buy side pool. The buy side members of the DC will be randomly selected from the buy side pool and serve for staggered one year terms. The buy side members on the DC must include at least one hedge fund and one traditional asset manager at all times. No institution can serve a second term until all eligible institutions have served. The proposal gives the buy side a direct voice and formal, permanent representation." *Id.*

[38] It resolves these issues by adhering to the standard of "commercial reasonableness." See ISDA Credit Derivatives Determination Committees Rules (July 11, 2011 Version), Rule 2.5 (b): "DC Resolutions" (Each DC Voting Member shall perform its obligations under the Rules in a commercially reasonable manner in Resolving a DC Question and shall base its vote on information that is either public or can be published). This of course begs the question whether this is an objective or subjective standard. Consider the example of SEAT Pagine Gialle, an Italian telephone directories and street maps publisher, active also in the online advertising sector. On November 28, 2011 the EMEA DC had a very hard time deciding whether a failure to pay credit event occurred with respect to that company meaning that those who had bought protection would get a big payout from those who had sold it to them. 8 members (including Bank of America Merrill Lynch, Barclays, Credit Suisse, Deutsche Bank AG and Morgan Stanley among other) voted that it di, but 7 other members (including Goldman Sachs, JPMorgan Chase Bank, N.A., BNP Paribas and Société Générale) voted that it did not. http://www.isda.org/dc/docs/EMEA_Determinations_Committee_Decision_28112011.pdf In the end, the payouts proved were worth some $465m in total. Luckily for the DC, the initially ambiguous situation was resolved by the company committing a more serious infringement on its debt. Lisa Pollack (FT Alphaville), "The conflicted Isda committee," FT.com (December 14, 2011) available at http://ftalphaville.ft.com/2011/12/14/799341/the-conflicted-isda-committee/ (last visited November 19, 2012). Admittedly, the case was complex. The Italian firm's bonds were issued by a Luxembourg-based special-purpose vehicle, which had a loan agreement with SEAT. When a payment was missed, there was debate over whether the grace period of the bonds - 30 days - should be applied to the loan (which would have otherwise have had a three-day grace period). But among the allegations concerning the bias was the fact that certain documentation that was not previously available suddenly surfaced. Chris Whittall, Dealers slam CDS

CDC member for each region is made publicly available on the ISDA's website. Members tend to be chosen from among the most important actors, in particular large sell-side institutions.[39] They also tend to be the same across regions. On numerous occasions this has given rise to allegations that the members vote in a way that benefits their financial institutions rather than with regard to some objective standard. And yet their decisions affect all CDS holders and in the end entire countries.

ISDA's power has two basic dimensions. One is *interactional* in the sense that it is shaped by behavioral relations or interactions, which, in turn, affect the ability of others to control the circumstances of their own behavior.[40] Membership is the cornerstone feature that enables interactional power to be exercised.[41] One of the consequences of the interactional nature of "organizational" power is that it is much easier to identify a particular class of persons to whom the organization *could* be accountable. (It may be more difficult to make a normative case for identifying the public to which the organization *should* be accountable). Accordingly, it is also much easier to legitimate its regulatory functions in procedural terms.[42]

ISDA's power is also *constitutive* in the sense that it produces the very social capacities of structural, or subject, positions in direct relation to one another, and the associated interests, that underlie and dispose action.[43] In other words, it is the power to constitute something new. "Whereas institutional power focuses on differential constraints on action, structural power concerns the determination of social capacities and interests."[44] The ability

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committee, International Financing Review (December 9, 2011) available at http://www.ifre.com/dealers-slam-cds-committee-'bias'/1619550.article (last visited November 19, 2012).

[39] The DC consists of 10 dealers and five buy-side firms. An 80% super-majority is needed to determine a credit event. CDC's resolutions are subsequently published on the website. The publication includes the determination itself, as well as (if appropriate an auction timeline, a list of participating bidders, any related resolutions, a list of deliverable obligation, the particular auction's settlement terms, a cash settlement/minimum transfer amount memorandum and other related information.

[40] As one ISDA representative remarked with regard to the role of the Association:

> "the funny thing about ISDA is that thousands of people think of themselves as part of the Association. One of our Board members said he counted 200 people in his firm alone who were active in ISDA committees, working groups and projects. We count all who work in the industry as part of ISDA. We represent them and like to publicize progress, regardless of which entity actually did the work – as long as it makes our markets safer and more efficient."

[41] ISDA provides for three types of membership: primary (mostly for sell-side banks) , associate (law firms, accounting firms) and subscribed (buy-side banks and financial institutions) membership. There are two types of benefits associated with the different categories of membership. The first type, which does not discriminate between the different categories encompasses the possibility of participating in the Association's numerous committees and task forces which serve to address issues in derivatives market, the possibility of receiving policy papers, response letters, market survey data, and communications on key business issues that ISDA and its consultants generate as well as eligibility to receive the Association's legal opinions on the enforceability of the netting provisions of the ISDA Master Agreements, which enable institutions to reduce credit risk and consequently capital requirements in jurisdictions subject to BIS capital regulations.

The second type of benefits, which does discriminate between members concerns voting rights. Only primary members are entitled to vote "on all matters submitted to a vote of the membership."

[42] One prominent commentator suggested that if ISDA wants to make itself more legitimate "it would . . . be sensible to encourage far more investor involvement. Just four of the 24 outside directors are from the buyside." Tett, Calls for radical rethink, *supra* note 14.

[43] Compare *id.*

[44] Barnett and Duvall, *Power in International Politics*, *supra* note 76.

to develop ad hoc protocols to deal with problems in liquidity is a good example of ISDA's constitutive power.

ISDA's constitutive power manifests itself even more importantly in the development of documentation for the derivatives market. The MA is, arguably, the most important document in these markets. In the context of contractual governance ISDA's constitutive power is indirect. Parties are free to modify the regulatory standards contained in the MA or use other documentation available. To the extent the parties use the MA, however, and rely on the regulatory standards developed by ISDA and recognized in domestic law, in addition to the effect that the contract might have on the parties themselves (in commercial terms), it is also the financial system as a whole that could be potentially affected, either in a positive or a negative way. This is because provisions such as close-out netting might have an effect on systemic risk. Their enforcement can either magnify it or help mitigate its proliferation.

3. GAL and private power

GAL is an approach to global governance that emphasizes accountability. It has been defined in a seminal article by Kingsbury, Krisch and Stewart as

> "comprising the mechanisms, principles, practices, and supporting social understandings that promote or otherwise affect the accountability of global administrative bodies, in particular by ensuring they meet adequate standards of transparency, participation, reasoned decision, and legality, and by providing effective review of the rules and decisions they make."[45]

Since it is the goal of the GAL project to define the unique properties of accountability in the context of global governance it does not define the term *ex ante*. But it would be rather uncontroversial to say that GAL's pursuit is informed by a descriptive account of accountability such as the one proposed, for example, by Ronald Oakerson – "[t]o be accountable means to have to answer for one's action or inaction, and depending on the answer, to be exposed to potential sanctions, both positive and negative."[46] This may be just *a* definition, but it is at least a *definition*, which gives GAL scholars, including the author of this paper, something to hold on to.[47]

The focus of GAL is thus on evaluating global administrative bodies from the standpoint of their accountability. These bodies include (1) formal international organizations; (2) transnational networks of cooperative arrangements between national regulatory officials; (3) national regulators under treaty, network, or other cooperative regimes; (4) hybrid intergovernmental–private arrangements; and (5) private institutions with regulatory functions.[48] Against the backdrop of this analytical outlook two things become immediately apparent. First, GAL is predominantly concerned with institutional or organizational arrangements in global governance. Accordingly, GAL scholarship develops rules and procedures that can help ensure the accountability of global administration, and it focuses in particular on administrative structures, on transparency, on participatory elements

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[45] Benedict Kingsbury, Nico Krisch & Richard Stewart, *The Emergence of Global Administrative Law*, 68 L. & CONTEMP. PROBS. 15, 17 (2005) [*hereinafter* Kingsbury et al, *The Emergence*].
[46] Oakerson, "Governance Structures," *supra* note 5 at 114.
[47] *Cf.* Nico Krisch, *The Pluralism of Global Administrative Law*, 17 EUR. J. INT'L L. 1, 247, 249 (2006).
[48] Kingsbury et al., *The Emergence*, *supra* note 22 at 20.

in the administrative procedure, on principles of reasoned decision-making, and on mechanisms of review.

Second, the GAL approach considers at least some private bodies to be essentially functionally equivalent to public ones. Accordingly, it is argued that private regimes should conform to at least some of the same requirements that apply to public ones, most importantly in terms of accountability. It is argued that, domestically, private actors often assume regulatory functions, but many of them under structures of delegation from public bodies, and all are embedded in an order in which public bodies, both administrative and legislative, possess relatively effective means of intervention to control or correct private governance.[49] In the global context, such a public order is largely lacking, and yet private bodies perform tasks with far-reaching consequences, often spurred by the absence of effective public regulation: as a result, mechanisms should be constructed in the global administrative space that address the realities of the roles played by private bodies.

What is the justification for considering public and (some) private bodies as functionally equivalent? Kingsbury suggests that whereas non-state norms and structures often originate as amorphous regimes of private ordering, they can have distributive consequences and do not exclusively regulate relations between private parties. As he puts it: "they often can be understood as beginning with private ordering," but ultimately they advance

> "towards a conception of the public and of public law. Indeed, many of the central issues are about the interaction between formally public institutions and officials – and the unofficial practices. The unofficial practices are dubbed 'private orderings' but in many cases they are not simply private. It is in their linkages that global administrative law operates."[50]

Consider the ISDA. Nominally it falls into GAL categories of global administrative bodies, specifically those that deal with banking and financial regulation. It is a private association formed by some of the most influential financial institutions in the world and it exercises a tremendous influence over the shape of derivatives markets across the globe. In fact ISDA has undergone a tremendous transformation since its inception in the early 1980s, both in terms of its organizational and professional culture and its inclusiveness and openness. It has expanded its membership, and became much more transparent. It can arguably be said to be evolving towards a conception of the public or 'publicness' that constitutes the normative benchmark of legitimacy in GAL literature.

4. Accountability in TCG: ISDA

A. The governance structure

A number of problems related to ISDA's prominence and quasi-monopoly in setting, monitoring, and to a certain extent enforcing the rules for the market have been pointed out in the literature.[51] These problems concern not only the role of the DCs, but ISDA itself.

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[49] *Id.* at 54.

[50] Benedict Kingsbury, *The Concept of 'Law' in Global Administrative Law*, 20 EUR. J. INT'L L. 1, 21, 31-33 (2009).

[51] For example in a 2007 article Frank Partnoy and David Skeel pointed out to some of the problems with ISDA and its governance. One of the major problems they saw with ISDA was that it resists disclosure of its

Partly in response to these calls, ISDA has undertaken notable efforts to change public perceptions. In the interests of more transparent decision-making, and improving the interface between interested parties (such as regulators, vendors and other infrastructure providers), in late 2009 ISDA published a governance structure for the OTC derivatives industry's market practice and post-trade activities.[52]

The industry's governance structure determines its relationships with other industry stakeholders, including regulators and vendors, as well as other industry infrastructure providers. Broadly speaking, the industry governance structure has been refashioned to resemble a three-layered structure comprising:

- the ISDA Industry Governance Committee (IIGC) (Layer 1);
- the Steering Committees (SCs) (Layer 2); and
- the Implementation layer (Layer 3).

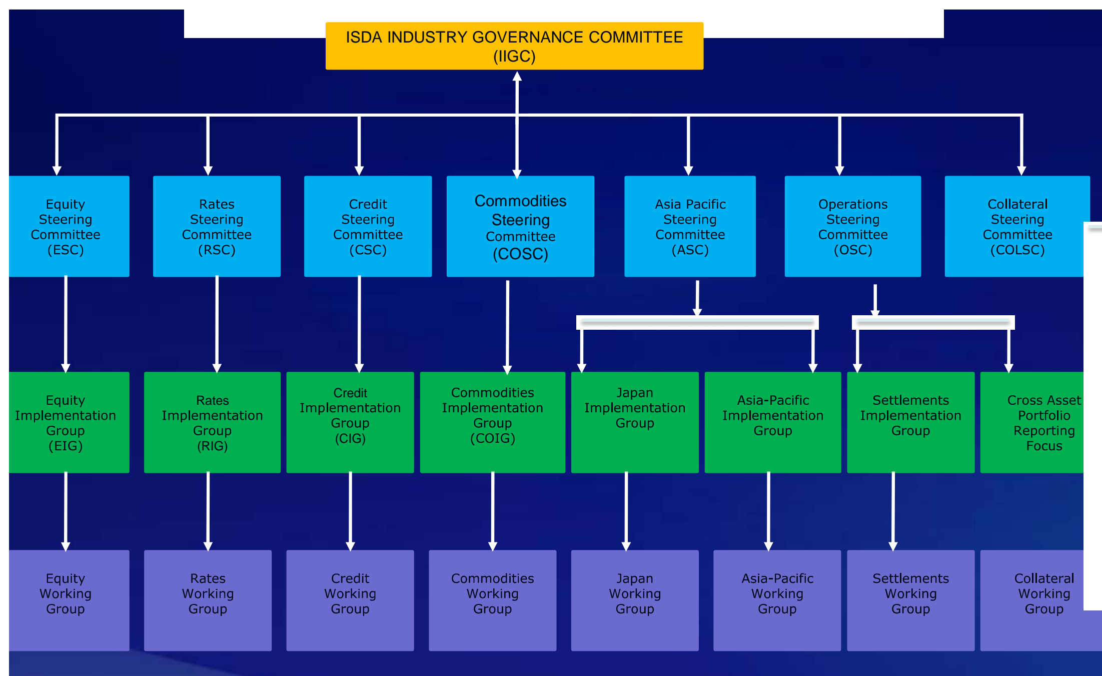

Figure 1: ISDA's governance structure (source: ISDA)

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documentation. They also expressed a concern that ISDA may develop standardized documentation and approaches that benefit ISDA members at the expense of others, either because they redistribute resources among parties, create or take advantage of informational asymmetries, or create negative externalities. See Frank Partnoy & David A. Skeel Jr., *The Promise and Perils of Credit Derivatives*, 75 U. CIN. L. REV. 3, 1019 (2007) ("If a few major dealers control ISDA documents, those agreements might be written either with dealer -to-dealer contracts in mind (and therefore might not be appropriate for-contracts between a dealer and an end-user), or might be constructed to advantage dealers in dealer-to-end-user contracts. The leadership of ISDA does appear to be dominated by a small number of major dealers. In contrast, end-users of derivatives are much more numerous and diffuse, and therefore face collective action problems in creating a plausible set of alternative legal rules. Moreover, end-users are not entitled to vote on ISDA decisions, and do not have any substantial role in formulating legal rules."). *Id.* at 1039.

[52] ISDA, "OTC Derivatives Industry Governance Structure", 2nd Edition (15 December 2010) available at www.isda.org/c_and_a/pdf/Industry-Governance.pdf (last visited November 5, 2012).

In Layer 2 there are four SCs related to individual asset classes (specifically, rates, equities, credit and commodities), two SCs that operate at the cross-product level (specifically, operations and collateral) and one SC that operates on the geographic level (Asia Pacific). In Layer 3 there are eight Implementation Groups and eight Working Groups (WGs), with Implementation and Working Groups largely operating under corresponding SCs.

ISDA asserts that there are

> "Two underlying and fundamental principles of the governance structure in relation to (i) where responsibility and ownership lie for the strategic direction of market practice and post-trade activities, and (ii) which groups are responsible for liaising with regulators, and at what levels. In respect of (i), it is intended that direction and leadership on all significant cross-asset class issues, either current or emerging, should come from the IIGC. Examples would include cross-asset class strategies for clearing access and trade repositories. For significant asset class-specific issues, to avoid the risk of any cross-mandates, the authority of the relevant product SC will take precedence over that of any cross-asset class Steering Committee; here examples would include equity MCA prioritization, varying approaches to portfolio compression by asset class and novation processes in respect of asset classes where novations are prevalent.
>
> The Operations SC will take the lead on issues of an operational or procedural nature with limited business, legal or risk impact; examples would include agreeing confirmation backlog reduction targets, improving electronic confirmation throughput performance, and tracking progress against operations commitments generally ... . A key example of where the Collateral SC would lead would be portfolio reconciliation. These Steering Committees also perform a communications role in that their meetings are used as *fora* to report upon the actions and decisions of other Committees and groups.
>
> With regard to (ii), market participants agree that regulatory contact should be conducted at the appropriate level and between appropriate groups and individuals. Accordingly, contact with regulators (whether initiated by industry or regulators themselves) on:
>
> - Cross-asset class strategic issues should take place between regulators and any or all of (as the regulators see fit), (i) the Chairs of the IIGC, and (ii) relevant staff from ISDA, AMG and MFA. and;
> - Strategic asset-class specific, or strictly operations or collateral issues, between regulators and any or all of (as the regulators see fit), (i) the Chair of the relevant SC, and (ii) relevant staff from ISDA, AMG and MFA and,
> - Technical and delivery-related operations and collateral matters between regulators and any or all of (as the regulators see fit) (i) the Chairs of the relevant Implementation Groups, and (ii) relevant staff from ISDA, AMG and MFA, but discussions at this level should not touch on strategy or direction for the industry."[53]

There can be little doubt that ISDA's effort to make its structure more transparent has not only been motivated by public calls for transparency, but also by the desire to preempt some of the regulatory proposals that have been contemplated by legislators on

[53] *Id.* at 2.

both sides of the Atlantic.[54] But whatever ISDA's motivation has been in adopting such a relatively transparent structure, the industry can, with such a structure in place, better represent itself in a cohesive and comprehensively representative manner to the regulatory community. Not unlike the Basel Committee of Banking Supervision (Basel Committee), ISDA has come a long way from the purely closed 'club' model of its origins, and demonstrates the possibility for enhanced accountability and legitimacy in transnational regulation, including TCG.[55]

But it may be insufficient to merely look at ISDA's accountability with reference to the inclusiveness and the transparency of its governance structure. GAL suggests that accountability in global governance is also a matter of the possibility of having the decisions made by global administrative bodies effectively reviewed. From that point of view ISDA's accountability is also a function of the governance rules that it sets, in particular through the documentation it develops. The next subsection examines two aspects of ISDA's "substantive" activity – the development of the MA and the way the MA has been accommodated in national legislation as a result of ISDA lobbying and legislative action in states; and the workings of DCs – with a view to demonstrating the possibility of holding ISDA accountable for its activities in these "substantive" domains. The justification for this inquiry is to be found in the recognition that ISDA's constitutive power manifests itself both in the development of documentation for the derivatives market and in determination of social capacities and interests through quasi-administrative functions of the DCs. The accountability question is particularly relevant here because ISDA's activities in these two domains can potentially have systemic consequences. In other words, they can affect systemic risk.

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[54] Shannon D. Harrington, "OTC Derivatives Industry Revamps Market Governance (Update1)", Bloomberg.com (December 2, 2009) available at http://www.bloomberg.com/apps/news?pid=newsarchive-&sid=adzko0br3qZs (last visited on November 5, 2012) (""They're attempting to preserve the OTC market," said Robert Claassen, a partner and derivatives lawyer in Palo Alto, California with Paul, Hastings, Janofsky & Walker. Improving the market's structure and governance may help to deflect "rules that could potentially wipe out the OTC derivatives market.""). *Compare* Michael L. Barnett, Andrew A. King, *Good Fences Make Good Neighbors: A Longitudinal Analysis of an Industry Self-Regulation Institution*, 51 ACADEMY MANAG. J. 6, 1150-1170 (2008) (extending theories of self-regulation of physical commons to analyze self-regulation of intangible commons in modern industry. They found that "[f]irms in an industry share an intangible commons that binds them to a shared fate. As with a physical commons, when the intangible commons is damage, it can pose a serious threat to the success and survival of the firms that share it." Thus firms in an industry may want to join forces in order to protect their reputation. But they may also want to act together to the extent that collective action creates for them the possibility of acting in a self-regulatory environment and precludes public regulation.).

[55] *Cf.* Michael S. Barr and Geoffrey P. Miller, *Global Administrative Law: A View from Basel*, 17 EUROPEAN JOURNAL OF INTERNATIONAL LAW 1, 15-46, 17 (2006) [hereinafter Barr & Miller, *A View from Basel*]. *Compare also* Maciej Borowicz, "The internal ratings-based and advanced measurement approaches for regulatory capital under the 'Basel regime,'" *in* FABRIZIO CAFAGGI & GEOFFREY MILLER, THE GOVERNANCE OF INTERNATIONAL BANKING (*forthcoming*).

B. The regulatory function of the MA

Systemic risk is the central problem that has emerged from the 2008 financial crisis. It is usually defined as the risk that the failure of one significant financial institution can cause or significantly contribute to the failure of other significant financial institutions as a result of their linkages to each other.[56] As Hal S. Scott observes, derivatives markets are one of the four principal linkages that can result in chain reaction failures.

> "The concern with derivatives is that if institution X fails to settle its derivative position with institution Y, both X and Y will fail. If Y in turn cannot settle its positions, other institutions will also fail. This risk proved potentially significant in the failure of the hedge fund Long-Term Capital Management in 1998. Concerns of this type also underpaid JPMorgan Chase's assisted acquisition of Bear Stearns and the injection of federal funds into AIG."[57]

The concern about systemic risk has led legislators in the US (as well as in many other countries) to grant priority in bankruptcy to the non-defaulting party in a derivative contract vis-à-vis other creditors.[58] Derivatives, in effect, have been given an "immunity" from one of the foundational rules of bankruptcy law, that of automatic stay. Automatic stay generally operates as an injunction that halts actions by creditors collect debts from a debtor who has declared bankruptcy. Thanks to an exemption from the Bankruptcy Codes' automatic stay—which bars all other creditors from terminating contracts with or seizing assets from a firm in bankruptcy—counterparties to these derivatives contracts are free to terminate the contracts and then seize collateral to the extent that they are owed money. These immunities, as reported in legislative history, were intended to contain the spread of economic contagion and protect the markets from systemic risk.[59]

On the contractual side the legal mechanism that allows for this is the close-out netting provision of the MA. As a general matter, netting refers to a procedure whereby the ongoing obligations of parties to an OTC transaction, or number of transactions, are

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[56] Hal S. Scott, *The Reduction of Systemic Risk in the United States Financial System*, 33 HARV. J. L. & PUB. POL., 671, 672 (2010). Compare Steven L. Schwarz, *Systemic Risk*, 97 GEO. L. J. 1, 193-249, 204 (2008) (defining systemic risk as: "the risk that (i) an economic shock such as market or institutional failure triggers (through a panic or otherwise) either (X) the failure of a chain of markets or institutions or (Y) a chain of significant losses to financial institutions, (ii) resulting in increases in the cost of capital or decreases in its availability, often evidenced by substantial financial-market price volatility.").

[57] Scott, *The Reduction of Systemic Risk*, supra note 52 at 675.

[58] *Compare* "The legislative history to the Act to Amend Title 11 of the United States Code Regarding Swap Agreements and Forward Contracts," Pub. L. 101-311, 104 Stat. 268. H.R. Rep. No. 97-420, at 1 (1982). These amendments resulted in the enactment of the following provisions: 1 11 U.S.C. §§ 362(b)(17) ("The filing of a petition under [this] section ... does not operate as a stay ... of the exercise by a swap participant or financial participant of any contractual right ... under any security agreement or arrangement or other credit enhancement forming a part of or related to any swap agreement, or of any contractual right (as defined in section 560) . . . ."), 362(b)(27) (2006) ("The filing of a petition under [this] section . . . does not operate as a stay . . . of the exercise by a master netting agreement participant of any contractual right . . . under any security agreement or arrangement or other credit enhancement forming a part of or related to any master netting agreement, or of any contractual right .. .."); see also §§ 362(o) ("The exercise of rights not subject to the stay arising under subsection (a) pursuant to paragraph (6), (7), (17), or (27) of subsection (b) shall not be stayed by any order of a court or administrative agency in any proceeding under this title.").

[59] *See* In re Quebecor World (USA), Inc. v. American United Life Insurance Company, 453 B.R. 201, 5 Bankr. Ct. Dec. 60 (2011).

determined by netting or aggregating obligations, with the difference between these two aggregates then producing a single settlement figure.[60] A netting agreement will in general be subject to the principle of the parties' freedom of contract, and there are no particular obstacles to its enforceability as long as both parties are solvent. However, the situation is very different in the event of insolvency of one of the parties. In these cases bankruptcy law generally trumps parties' freedom of contract. This is why the special treatment of derivatives described above was needed.[61] ISDA has been very consistent that OTC exemptions from bankruptcy laws are entirely warranted in order to protect the health of the OTC markets and the financial system as a whole. In particular "ISDA posits that … a failure of a derivatives market player could prompt a destabilizing domino effect, threatening the positions of other market participants which might be intertwined in trades with the insolvent, ultimately generating systemic risk."[62] This is why in the MA we also find Section 2(a)(iii) – the close-out netting provision:

> "Each obligation of each party [to make payment or delivery under the master agreement] is subject to (1) the condition precedent that no Event of Default or Potential Event of Default with respect to the other party has occurred and is continuing, (2) the condition precedent that no Early Termination Date in respect of the relevant transaction has occurred or been effectively designated and (3) each other applicable condition precedent specified in this Agreement."

According to the express terms of section 2(a)(iii), following the occurrence and during the continuance of an event of default, the non-defaulting party is not required to terminate the ISDA master agreement following an event of default, with concomitant termination amounts owing to the defaulting party if the non-defaulting party is out of the money, and it equally is not required to perform obligations under the ISDA master agreement. Figure 2

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[60] This mechanism is provided for under Section 2(c) of the MA, which reads:

> *Netting of payments.* If on any date amounts would otherwise be payable: - (i) in the same currency; and (ii) in respect of the same Transaction, by each party to the other, then, on such date, each party's obligation to make payment of any such amount will be automatically satisfied and discharged and, if the aggregate amount that would otherwise have been payable by one party exceeds the aggregate amount that would otherwise have been payable by the other party, replaced by an obligation upon the party by which the larger aggregate amount would have been payable to pay to the other party the excess of the larger aggregate amount over the smaller aggregate amount.

[61] In other words, as long as market participants use appropriately designed master agreements a special "super-senior" category of property rights is created in bankruptcy for the non-defaulting counterparties. Compare 11 U.S.C. § 560 (2006) ("The exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of this title or to offset or net out any termination values or payment amounts arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title."). See 11 U.S.C. § 101(38B) (2006) ("The term 'master netting agreement participant' means an entity that, at any time before the date of the filing of the petition, is a party to an outstanding master netting agreement with the debtor."). In essence, the statute converts derivative counterparties' setoff rights into recoupment rights, without the requirement that the underlying obligations arise out of the same transaction or occurrence.

[62] *See* David Mengle, "The Importance of Close-Out Netting" (ISDA Research Notes, Number 1, 2010) available at http://www.isda.org/researchnotes/pdf/Netting-ISDAResearchNotes-1-2010.pdf (last accessed December 2, 2012).

illustrates the effect of close-out netting on settlement of outstanding amounts in bankruptcy.

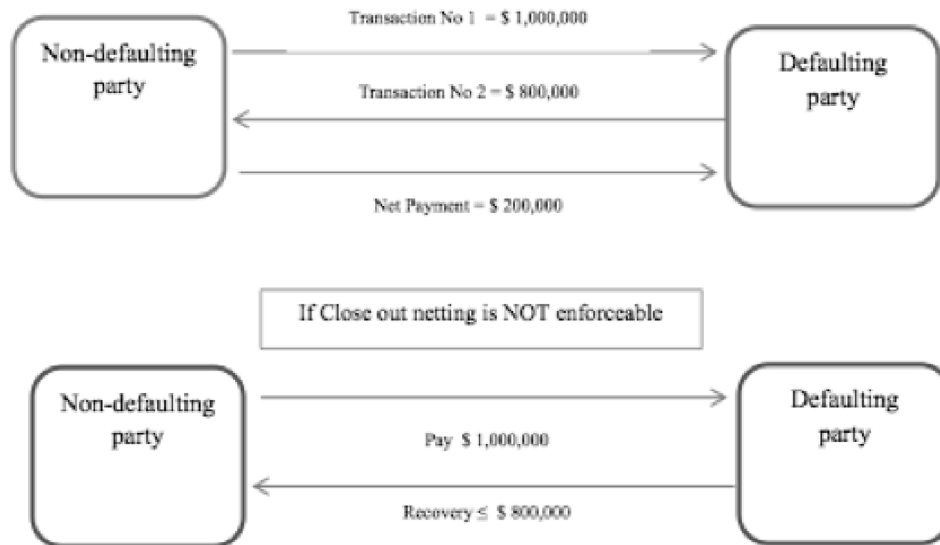

Figure 2: Close-out netting (source: ISDA)

This provision has complex economic implications, of both an individual and systemic nature.[63] From an individual perspective the beneficial effect mainly consists in a reduction of counterparty risk on the one hand, and a more favorable position in terms of the underlying capitalization on the other hand. By aggregating the amounts owed, both parties reduce their exposures towards their counterparties and thereby also reduce their need for regulatory capital.[64]

From a systemic point of view the use of close-out netting can prevent the risk of contagion from becoming systemic, i.e. affecting the financial market in such a way that it becomes dysfunctional. This beneficial effect is grounded in the idea that close-out netting shields systemically important market participants from the consequences of their counterparty's insolvency.

These benefits have been recognized by some of the most important global macroprudential oversight bodies, including the Cross-border Bank Resolution Group (CBRG) of the Basel Committee. In its recent report CBRG mentions enforceable netting

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[63] *See* Robert R. Bliss and George G. Kaufman, *Derivatives and Systemic Risk: Netting, Collateral, and Closeout*, 2 J. FIN. STAB. 1, 55-70 (2006).

[64] It should be stated at the outset that close out netting has evolved for purposes other than reducing systemic risk reduction. "Market participants tend to be more concerned with their own welfare in normal day-to-day business environments than with possibilities of adverse externalities in the form of systemic failures of markets. Netting, close-out, l serve the needs of market participants even when there is no systemic threat: they facilitate market risk and counterparty credit risk management; and they permit expansion of dealer activities, enhancing the depth and liquidity of the derivatives markets." *Id.* at 57

agreements in a list of mechanisms capable of mitigating systemic risk in the first place, along with collateralization, segregation of client assets and standardization and regulation of OTC derivatives transactions. It calls upon national authorities to promote the convergence of national rules governing the enforceability of netting agreements with respect to their scope of application and legal effects across borders.

These recommendations are based, in part, on the data produced by the Bank for International Settlements (where the Basel Committee is housed).[65] According to a recent BIS report, at the end of 2011 the notional amount of all types of OTC contracts stood at approximately USD 650 trillion. The gross market value of these contracts, i.e. the cost of replacing all of them by equivalent contracts at the market price, was USD 27 trillion. This amount corresponds to the market risk inherent in these contracts, i.e. market participants were, on an aggregate basis, exposed to each other by that sum. At the same time, aggregate actual credit exposures of market participants, i.e. the remaining credit risk taking into account legally enforceable netting agreements, amounted to USD 3.9 trillion, which represents a risk reduction of 85%.

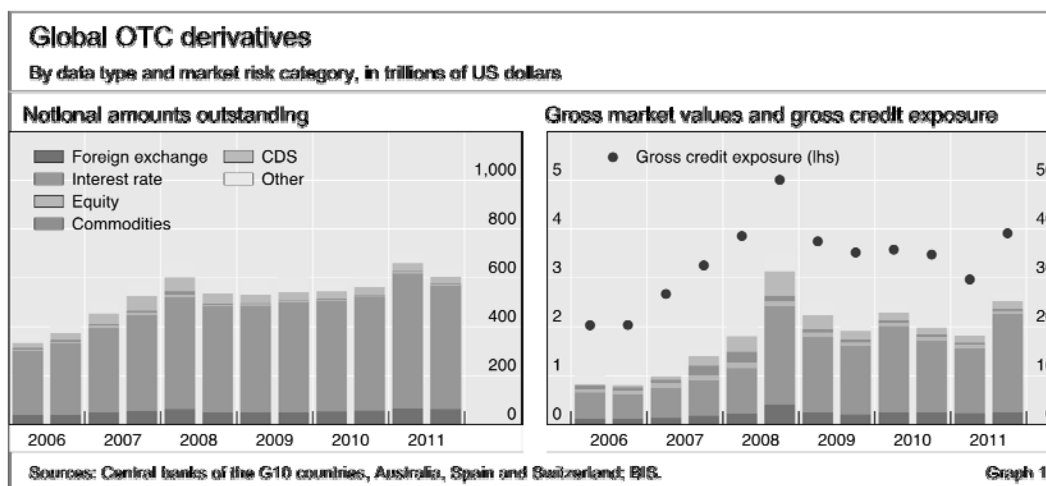

Figure 3

Similar results are reported by the US Office of the Comptroller of the Currency (OCC) quarterly reports on bank trading and derivatives activities. The reports endorse the efficacy of netting with legally enforceable netting agreements. The most recent report[66] states that Net Current Credit Exposure (NCCE)[67] for U.S. commercial banks was US$353 billion in the first quarter of 2011, after netting derivatives receivables and payables. The OCC's report

[65] Bank for International Settlements, Statistical release: OTC derivatives statistics at the end-December 2011 (May 2012).

[66] Office of the Comptroller of the Currency, OCC's Quarterly Report on Bank Trading and Derivatives Activities, First Quarter 2011, http://occ.gov/topics/capital-markets/financialmarkets/trading/derivatives-/dq111.pdf.

[67] A financial institution's NCCE across all counterparties is the sum of the gross positive fair values for counterparties without legally certain bilateral netting arrangements (this may be due to the use of non-standardized documentation or jurisdiction considerations) and the net positive fair values for counterparties with legal certainty regarding the enforceability of their netting agreements. See ISDA, Netting and Offsetting: Reporting derivatives under U.S. GAAP and under IFRS (May 2012) at 17.

estimates that netting with legally enforceable netting agreements allowed counterparties to reduce Gross Positive Fair Value (GPFV) exposures by 90.4 per cent in the first quarter, the second consecutive decline in this metric since it peaked at 92.1 per cent set in the third quarter of 2010.

Table No. 3				
US$ in billions	Q111	Q410	Change	%
Gross Positive Fair Value (GPFV)	3,687	4,198	(540)	-12%
Netting Benefits (GNFV)	3,335	3,822	(487)	-13%
Netted Current Credit Exposure (NCCE)	353	375	(23)	-6%
Netting Benefit in %	90.4%	91.1%	-0.6%	-1%
Source OCC				

Figure 4

The OCC's report shows that the netting benefit was greater than 90 per cent of all derivatives contracts traded, indicating that the net amounts are more relevant when reporting derivatives than the gross amounts when evaluating and measuring derivative exposures. Similarly, the total NCCE, amounting to US$353 billion of credit risk, should have to be divided among all counterparties trading in derivatives regulated by the OCC.[68]

At the same time it is not entirely clear whether close-out netting played a principally positive role. As David A. Skeel and Thomas H. Jackson recently pointed out, discussing the case of AIG, the insurer's problems in the wake of the crisis may have been magnified by the existence of this regulatory mechanism.[69] When AIG's financial difficulties became apparent the company was forced to begin posting collateral for its large portfolio of CDS due to ratings downgrade. "AIG's counterparties demanded higher levels of collateral to be posted to the extent that further compliance with those demands threatened the existence of AIG."[70] The government had to step in. Skeel and Jackson further suggest that "if the CDS had been subject to an automatic stay in the event of bankruptcy, AIG could have just said no to the collateral demands, knowing that bankruptcy would offer a stay and a breathing space for arranging a response."[71] In other words – they seem to suggest - it might have been a better idea not to allow for close-out and termination, at least not immediately as of the occurrence of the event of default.

Interestingly, however, what Skeel and Jackson call for is not an abandonment of the special status of derivatives, but rather a limitation on the exercise of close-out and netting rights contained in such agreements. They do not deny that the MA performs a regulatory function, but – because it can have an adverse outcome – it should be, well... regulated. This is why they argue that the exercise of the close-out right should be delayed in time. The new reform legislation in the US includes a one-plus day halt on termination (which will function similarly to an automatic stay) in resolution proceedings. Skeel and Jackson posit that three business days would be a better idea, workable even in complex cases.[72] Following that

[68] OCC's Quarterly Report on Bank Trading and Derivatives Activities, *supra* note 65.
[69] Skeel & Jackson, *Transaction Consistency*, *supra* note 17.
[70] *Id.* at 166.
[71] *Id.*
[72] *Id.* at 184.

period counterparties would still be authorized to close out and net all of the contracts, not just individual contracts, in the event of default under the ISDA MA. The regulatory function of the ISDA MA would be 'calibrated' in a way that would help mitigate systemic risk rather than magnify it, as was arguably occurring, at least in some instances, in the early days of the financial crisis. Thus, without prejudice to the substantive effects of the provision, its legislative recognition as well as the possibility of 'calibrating' it is one of the mechanisms through which the review of ISDA's decision can be ensured, both in an *ex ante* perspective – when the rules are first enshrined in the law, as well as *ex post*, when they are subsequently modified.

Whether it helped to magnify or mitigate systemic risk, the close-out netting provision is perhaps the clearest example of the regulatory function of the MA. The regulatory function consists in particular of setting of rules that create externalities. Some of them are positive (as in reducing transaction costs for market participants or mitigating systemic risk); some are negative (as in reducing competition on contract terms and compounding systemic risk). A meaningful accountability mechanism would suggest that there should be a possibility of having these rules reviewed. The next two sub-sections will argue that the review process occurs, in an *ex ante* and an *ex post* perspective, at the domestic level, through legislative and judicial recognition.

C. Accountability through legislative recognition

ISDA leadership of the industry on derivatives issues is perhaps most exemplary when the organization lobbies to have its rules – such as the close-out netting provision – recognized in relevant jurisdictions. As Annelise Riles observed in her study of derivatives markets:

> "where the terms in ISDA's standardized documents conflict with the norms enshrined in national statutory or judge-made law, ISDA actively works to supplant or change the latter so that it conforms to the former. ISDA hires local lawyers to investigate discrepancies between the terms of ISDA documents and national law, and where necessary, to lobby national governments to change national law to either conform to the terms of the Master Agreement or explicitly declare the ISDA documents enforceable."[73]

In order to facilitate recognition of close-out netting, in 2006 ISDA released what is known as the Model Netting Act (MNA). The MNA is a model law intended to set out, by example, the basic principles necessary to ensure the enforceability of bilateral close-out netting, including bilateral close-out netting on a multibranch basis, as well as the enforceability of related financial collateral arrangements.[74] As of August 2012 at least 46 countries had adopted or were considering netting legislation,[75] which by all standards is a rather remarkable success for an initiative of a private organization.[76]

The adoption of netting legislation is one of the mechanisms of ex-post facto review of ISDA decisions. At the same time it is, arguably, only the case where the legislative debate

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[73] Annelise Riles, *The Anti-Network: Private Global Governance, Legal Knowledge, and the Legitimacy of the State*, 56 AM. J. COMP. L. 605 (2008).

[74] The MNA is available at ISDA's website under "Opinions," available at http://www2.isda.org/functional-areas/legal-and-documentation/opinions/ (last visited on November 20, 2012).

[75] *Id.* under "Netting Opinions - list by country."

[76] *See* http://www.unidroit.org/english/studies/study78c/main.htm (last visited November 21, 2012).

is actually meaningful. A legislative debate is meaningful if it produces an outcome that is not a mere result of legislators rubber-stamping whatever is put in front of them by those who have a direct interest in the outcome. Rather the debate should be informed by a comprehensive assessment of the effects that the adoption of a specific measure will have. This is not to say that ISDA's efforts to have its documentation recognized were necessarily deficient in that regard. But there is merit to the arguments that have been made, both before and in the aftermath of the 2008 crisis, that at least some of the consequences of legislative recognition of enforceability of close-out netting have not been sufficiently thought through and discussed.[77]

A more comprehensive discussion of the desirability and feasibility of developing an international instrument on the enforceability of close-out netting was recently initiated by the International Institute for the Unification of Private Law (UNIDROIT). UNIDROIT's initiative can be instructive in how to achieve a more meaningful debate about a regulatory standard, one which would ensure that legislative recognition of the standard is in fact a way in which ex post facto accountability is achieved. At its 67th session (Rome, 1 December 2010) UNIDROIT's General Assembly approved the work programme for the triennium 2011-2013, endorsed the recommendation of the Governing Council concerning the development of an international instrument on netting, and assigned the highest level of priority to this subject. UNIDROIT has commissioned a study assessing the extent of legal risk arising out of situations involving cross-jurisdictional netting and identifying the causes of legal obstacles to the proper operation of netting agreements. Additionally, the study explores possible solutions and appropriate steps to take, if any. The Secretary General of UNIDROIT set up a Study Group of renowned experts in the law of international financial markets, which met in April 2011, in September 2011 and in February 2012. The Study Group established a set of draft Principles regarding the enforceability of close-out netting provisions. At its 91st session (Rome, 7-9 May 2012), the UNIDROIT Governing Council endorsed the proposal of the Secretariat to convene a Committee of governmental experts for further consideration and finalization of these draft Principles for adoption by the Governing Council. The first session of the Committee of governmental experts took place on 1-5 October 2012. During that session representatives of governments and organizations were encouraged to comment on the draft Principles. The comments came from, *inter alia*, the governments of Brazil, Canada, France, Poland, Sweden and the United States, as well as the United Nations Commission on International Trade Law (UNCITRAL) and the World Bank. A detailed report from the sessions is available from UNIDROIT's website.[78] The second session is scheduled to be held on 4-8 March 2013 in Rome.

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[77] As Partnoy and Skeel wrote back in 2007: "Although we believe there are strong policy arguments that credit derivatives should be subject to the same substantive regulation as other economically equivalent instruments, such as bonds and loans, we recognize that such changes are unlikely as a political matter." Partnoy & Skeel, *The Promise and Perils of Credit Derivatives supra* note 51 at 1047. See also Patrick Bolton, Martin Oehmke, "Should Derivatives be Privileged in Bankruptcy?", NBER Working Paper No. 17599 (2011) ("[W]hile derivatives are value-enhancing risk management tools, super-seniority for derivatives can lead to inefficiencies: collateralization and effective seniority of derivatives shifts credit risk to the firm's creditors, even though this risk could be borne more efficiently by derivative counterparties. In addition, because super-senior derivatives dilute existing creditors, they may lead firms to take on derivative positions that are too large from a social perspective.").

[78] http://www.unidroit.org/english/documents/2012/study78c/cge-01/cge-1-report-e.pdf (last accessed on December 2, 2012).

D. Accountability through judicial and non-judicial review

The analysis of the regulatory function of the close-out netting provision of the MA suggests that it may be insufficient to merely look at ISDA as an institution with reference to the inclusiveness and transparency of its governance structure. Rather, its accountability is *also* a function of the governance rules that it sets, in particular in the MA. ISDA's accountability *vis-à-vis* those rules, in turn, is achieved when there exists a possibility of having them reviewed. Skeel's and Jackson's argument illustrates the legislative dimension, in which provisions of the Dodd-Frank Act "adjust" the effect of ISDA's rules. A case from the US Federal Court for the Southern District of New York concerning the MA can help illustrate the role played by judicial review in providing some measure of accountability for ISDA decisions.

In the jointly administered bankruptcy case of Lehman Brothers Holdings International (LBHI) and Lehman Brothers Special Financing (LBSF) the New York Bankruptcy Court considered the effect of bankruptcy or insolvency on the rights of a non-defaulting counterparty under the close-out netting provision of the MA (s.2 (a)(iii)).[79] Recall that according to the express terms of the MA, following the occurrence and during the continuance of an event of default, the non-defaulting party is not required to terminate the ISDA MA, with concomitant termination amounts owing to the defaulting party if the non-defaulting party is out of the money, and it equally is not required to perform obligations under the ISDA MA.[80] In essence, the non-defaulting counterparty does not have to make payments. Metavante, a counterparty in a number of swaps transactions, relied on this reading of s. 2(a)(iii) and withheld its payments.

However, due to the substantial period of time that had passed since the commencement of the US Debtors' bankruptcy cases, the Bankruptcy Court ruled that Metavante had waived its right to terminate the swap agreement under the applicable safe harbor provisions. The Bankruptcy Code's automatic stay on actions against the debtor and its prohibition against the enforcement of ipso facto clauses prohibited Metavante from enforcing s 2(a)(iii) against the US debtors. Metavante's reliance on New York State contract law for the proposition that failure of a condition precedent excuses a party's performance obligation was trumped by federal bankruptcy law.

The court noted that while the Bankruptcy Code does not specify that non-defaulting counterparties must act promptly after a filing in order to rely on the protection afforded by its safe harbor provisions, the legislative history of the Bankruptcy Code establishes that Congress intended only to shield parties to financial contracts from the systemic risk that would result from cascading losses due to a counterparty's bankruptcy filing. Because the degree of systemic risk that could result from a single filing diminishes over time, both this decision and existing precedent held that the safe harbor only protects actions that are taken reasonably promptly after the filing date.

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[79] *See* FN 21. The case concerned Metavante Corporation's interest rate swap with LBSF incorporating the terms of the 1992 ISA Master Agreement. LBHI was a credit support provider under the Master Agreement. LBHI's bankruptcy filing on October 3, 2008 constituted an Event of Default under the Master Agreement that entitled Metavante to terminate the swap.

[80] Stephen H. Moller, Anthony R. G. Nolan, Howard M. Goldwasser, *Section 2(a)(iii) of the ISDA Master Agreement and Emerging Swaps Jurisprudence in the Shadow of Lehman Brothers*, J. INT'L BANK. L. & REG., Issue 7 (2011).

The other set of ISDA's decisions which, as has been mentioned earlier, warrant review, are decisions of the DCs. DCs are composed of ISDA members who, in essence, have the biggest positions in any CDS contract under examination and as such are not independent bodies, neither institutionally nor in terms of the rules that they are bound to apply. At the same time, their decisions affect all CDS holders. ISDA usually invokes several arguments in defense of the current structure of the DCs. First, it argues that the workings of the DCs are transparent, because both the rules of the DCs and the votes cast are made publicly available. Moreover, it is argued, most of the time, the decisions of the DC are incredibly straightforward and pose little controversy. Thirdly, everyone in the industry signed up to the Big Bang Protocol, which gave the DCs the powers that they have. In other words, ISDA suggests that the DCs are a voluntary and representative mechanism. But as Lisa Pollack of the *Financial Times* correctly points out, these are not necessarily meaningful benchmarks of transparency and legitimacy. "Wouldn't true transparency mean that DC members disclosed the financial interests of their firm and their votes? Wouldn't it be refreshing to see them vote against their own position? Admittedly the benefit of the doubt would then have to be given to those who voted in the direction of their firm's interest".[81] She finds the ISDA's two other arguments equally unpersuasive, suggesting that the legitimacy of a governance arrangement may be better tested in "hard cases" and that not signing the Big Bang Protocol was hardly a choice for most market participants.[82]

The conflicted nature of the DC mechanism is somewhat mitigated in situations in which the 80% threshold required for a DC decision is not met,[83] and the decision goes to external review. The external review panel is composed of individuals who have earlier been selected to be pool members in a region. The panelists are then selected by members of a convened DC for the same region and screened for potential conflicts of interests.[84] Five

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[81] Lisa Pollack (FT Alphaville), More on the conflicted Isda committee (December 14, 2011) available at http://ftalphaville.ft.com/2011/12/14/799741/more-on-the-conflicted-isda-committee/ (last accessed November 20, 2012).

[82] *Id.*

[83] "This high level of consensus safeguards against either protection buyers or protection sellers unilaterally making a determination as a single block. Similarly, to address concerns that dealer members may all be on one side of the market with respect to a given issue, the threshold is high enough to ensure that dealer members cannot reach a decision by 80% supermajority without the support of at least two non-dealer members. In practice, there have been no dealer vs. non-dealer voting splits." ISDA, The ISDA Credit Derivatives Determinations Committees (ISDA material on file with author).

[84] 4.3 Composition of the External Review Panels

> (a) Conflicts. Upon the existence of an Eligible Review Question, any Convened DC Voting Member may identify any Pool Member from the External Review Panel List for the same Region as such Convened DC for purposes of analyzing their availability and potential conflicts of interest with respect to such Eligible Review Question (each such Pool Member, a "Potential External Reviewer"). Each Potential External Reviewer shall notify the Convened DC, via the DC Secretary, by 5:00 p.m. Relevant City Time on the first Relevant City Business Day after being designated a Potential External Reviewer or such other time as the Convened DC Resolves by a Majority, of its availability and disclose to the Convened DC any conflict of interest which exists or is foreseeable with respect to either the Reviewable Question or the related DC Questions which may be deliberated by the Convened DC. Any 46 Convened DC Voting Member or Convened DC Consultative Member may also raise an existing or potential conflict of interest with respect to a Potential External Reviewer or may ask for additional information to be disclosed.

panelists must be selected by a unanimous vote of a DC. According to ISDA, the robustness of the review process derives from its reliance on independent, third-party professionals with market and/or legal expertise (such as British Queen's Counsels, academics, and other independent legal experts who specialize in the derivatives market). External review involves formal arbitration-style briefing and argument, with all written arguments made public. ISDA members can submit a brief in connection with the reviewed question.[85] As such the review mechanism offers, at least from a formal standpoint, much of what could be expected from an effective review mechanism, except maybe for the fact that only a very limited spectrum of cases is allowed for review.

5. Conclusion

This paper developed a model of accountability in TCG by looking at the ways in which private institutions, such as banks, interact in the transnational context. TCG is one of the ways in which private actors leverage their power. Insofar as the exercise of that power generates negative externalities it is important that the institutions that set the standards of TCG for a particular market monitor the market, and to a certain extent enforce these standards, are accountable to the relevant publics. The model outlined here consists of a combination of transparency-like standards *vis-à-vis* the organizations that are primarily responsible for the design of TCG in a particular market as well as legislative and judicial recognition of the regulatory standards contained in the documentation developed in TCG. This model of accountability makes TCG responsive to both cosmopolitan and national constituencies and strengthens the argument for conceptualization of GAL as a pluralist legal order.

This model has been developed based on an investigation of the particular regulatory features of TCG in derivatives markets. In derivatives markets ISDA is the organization that is primarily responsible for the design of TCG, and the most important standards are contained in the ISDA MA, as well as related documentation. This paper demonstrated that ISDA's accountability fits well within the model. ISDA's accountability is generally ensured through a combination of transparency-like standards as well as legislative and judicial recognition of the regulatory standards contained in the documentation developed by ISDA. At the same time a meaningful understanding of legislative recognition requires that implementation of these regulatory standards is preceded by a debate about their potential effects. This debate can be mediated by international organizations with a relevant competence, such as – in the case of netting of contracts – the UNIDROIT. Another weak link of the ISDA regime *vis-à-vis* the model is the DC, which, despite the fact that its decisions can affect all CDS holders, is composed of the biggest market participants, who often, if not always, have a financial stake in the matter being decided. The inherent conflict of interest that exists in that arrangement is to a certain extent mitigated by the fact that the DCs decisions can, in certain cases, be subject to review by a panel of external experts.

Finally, despite the fact that this model is presented as a model of accountability in TCG, insofar as it is driven by large organizations and industry associations, it can be envisaged that it could also be applied in the public domain. Banking governance, insofar as

[85] *See e.g.* briefs submitted in connection with the CEMEX External Review, available online at: http://www.isda.org/dc/view.asp?issuenum=2009100901.

it is run by the Basel Committee, for example, would fit that model as well.[86] Admittedly, the standard of accountability may be higher insofar as public or quasi-public bodies are concerned (this would be true in particular of the requirement of transparency), but their accountability can largely be modeled in the same way.

[86] Compare Barr and Miller, *The View from Basel* (2009), *supra* note 55. Compare also Maciej Borowicz, "The internal ratings-based and advanced measurement approaches" *supra* note 55.