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MEMORANDUM FOR MEMBERS OF THE INTERNATIONAL SWAPS AND DERIVATIVES  
ASSOCIATION INC.

**Launch of the ISDA Legal Technology Working Group and the ISDA Clause Library Project**

**1. INTRODUCTION**

- 1.1 Over the past 30 years, ISDA has worked with its members to produce and maintain a documentation framework to support the growth of the derivatives industry. This has been achieved through the development of the ISDA Master Agreement and corresponding documentation, such as various annexes, definitional booklets and protocols. This framework has provided legal certainty, clarity and efficiency for derivatives market participants.
- 1.2 Whereas the core terms of the ISDA Master Agreement have largely remained, there has been an ever-increasing number of variants of its Schedule clauses. This has increased the time taken for negotiation and onboarding of new client relationships. Where these variances have different commercial and operational effects, this has led to a need for bespoke business processes to monitor and respond to the contractual obligations in place. The rapidly evolving regulatory landscape that has emerged since the events of the financial crisis has put further strain on the processes and systems reliant on specific Master Agreement terms.
- 1.3 These trends have led to a desire amongst many ISDA members to move to a more standardized approach to Master Agreement Schedule clauses, including exploration of various “legaltech” solutions.
- 1.4 ISDA has therefore established the Legal Technology Working Group (**LTWG**) to explore and discuss opportunities for further standardization of ISDA documentation and the development of legaltech solutions (such as ISDA Create).
- 1.5 An initial objective of the LTWG will be to develop and build an industry-wide foundational clause library for the schedule to the ISDA Master Agreement (the **ISDA Clause Library Project**).

- 1.6 This memorandum explores current market challenges in relation to the variations in clause language and the issues that arise as a consequence. It provides an overview of the ISDA Clause Library Project and details of the LTWG that has been set up to support this work.
- 1.7 After consideration of this memorandum, all interested ISDA members are invited to contact Ciarán McGonagle ([cmcgonagle@isda.org](mailto:cmcgonagle@isda.org)), Megan O’Flynn ([moflynn@isda.org](mailto:moflynn@isda.org)) or Erryan Abdul Samad ([eabdulsamad@isda.org](mailto:eabdulsamad@isda.org)) with any comments or questions.
- 1.8 **This memorandum is intended for general guidance to facilitate further discussion of these issues among members. It does not constitute legal advice. Members should seek specific advice from their own internal and/or external legal advisers in relation to the circumstances of individual matters or cases where they may wish to consider the use/implementation of this project with regards to their ISDA documentation and systems.**

## 2. THE LEGAL TECHNOLOGY WORKING GROUP

- 2.1 Despite a plethora of standard legal documents published for industry use, many documents are still customized between transacting parties. This presents a number of issues for market participants:
- The maintenance of customized templates and negotiation guides can result in protracted negotiation and client onboarding where commercial positions and preferred drafting options conflict with those maintained by their counterparties;
  - The drafting of bespoke contractual provisions can prevent certain data within the contract from being easily captured and recorded using electronic data capture systems requiring certain data to be recorded and verified manually;
  - Where contractual provisions are customized, a lack of common data and metadata standards may impede interoperability, reducing the efficiency and accuracy of systems designed to monitor, for example, netting enforceability, liquidity, credit risk and collateral management.
  - A lack of common standards around how more formal representations of existing contractual provisions might be introduced across ISDA documentation may present obstacles to the adoption of new technology, such as distributed ledger and smart contracts.
- 2.2 Increased standardization and digitization will drive more accurate data capture and more efficient trade processing, both within firms and across the market. A greater emphasis on standardization and digitization will also support the development of technology-enabled contract delivery solutions which will facilitate more efficient and cost-effective client onboarding. Finally, the adoption of common standards will drive development and adoption of technology by providing clear product and legal specifications for market participants and technology providers to build towards.
- 2.3 The extent to which the derivatives market will benefit from the increased use of technology such as DLT and smart contracts is likely to be dependent both on the establishment of foundational processes, data and documentation standards and the extent to which areas of legal and regulatory uncertainty in its use can be identified and resolved. Importantly, ISDA's Common Domain Model (CDM) introduces a common set of process and data standards that will increase automation and efficiency in the derivatives markets and upon which smart derivative contracts can be developed.
- 2.4 However, without enhanced legal agreement documentation standards, it will not be possible to truly unlock the business value offered by such standards and technologies. ISDA has therefore commenced work on a number of projects aimed at developing and promoting common legal and documentation standards as well as to provide members with platforms to facilitate this. Most recently, ISDA is collaborating with Linklaters to develop an online tool that will allow firms to electronically negotiate initial margin (IM) documentation.
- 2.5 ISDA has created the ISDA Legal Technology Working Group (LTWG) to explore and discuss opportunities for further standardization of ISDA documentation and to support the delivery of ISDA's legal technology strategy.

- 2.6 The LTWG will complement the work of the ISDA Smart Contracts/DLT Legal Working Group, which focusses on the legal, regulatory and governance issues related to smart contracts and distributed ledger technology and their potential application to derivatives transactions.
- 2.7 A separate ISDA CDM design group is working on further developing the ISDA CDM, which essentially digitizes parts of the ISDA documentation and derivatives contracts for which automation is already feasible today, and identifying opportunities for proofs of concept.

### 3. **THE ISDA CLAUSE LIBRARY PROJECT**

#### 3.1 **Standardization**

3.1.1 The current lack of standardization in ISDA documentation gives rise to operational inefficiencies, unsustainable costs and legal and operational risk.

3.1.2 For example, the Schedule to the ISDA Master Agreement continues to be a routinely and heavily negotiated document. This presents a number of challenges to firms:

- Firms typically maintain their own customized templates and negotiation guides which set out a menu of negotiated positions that their lawyers can choose from when negotiating an ISDA Master Agreement. These positions may conflict or be incompatible with those maintained by other firms, leading to lengthy contract negotiation. The client onboarding process can therefore consume a considerable amount of time and resource.
- Bespoke provisions often hinder the capture of legal agreement data from being accurate and precise, requiring manual and error-prone processes.
- Firms may have multiple systems which are either intended to capture contracts negotiated by different desks/businesses or which are designed to capture different aspects of the contract (netting enforceability, liquidity, credit risk etc.). Where negotiated provisions are bespoke, interoperability between these systems is often impeded.

3.1.3 To address these challenges, ISDA will shortly commence a new project (the **ISDA Clause Library Project**) to identify provisions within the schedule to the ISDA Master Agreement that might benefit from further standardization. As part of this analysis, ISDA will identify opportunities for creating standard form drafting options in respect of these provisions.

3.1.4 Increased standardization of clause language will:

- Provide the capacity to facilitate change, improve processes and use of documentation and data management technology whilst fully understanding the true impact and costs of particular clause wording;
- Promote the development of standardized and categorized legal agreement reference data governance across the industry; and
- Provide firms with better visibility and control over the documentation terms affected by certain events, facilitating a more automated response to the increasing regulatory requirements to report on Master Agreement clauses such as events of default and termination events.

3.1.5 It is important to note that clause standardization does not mean standardization of, or restrictions on, the terms firms may agree in their bilateral documents. Standardization of clause language does mean standardizing the way in which firms agree terms in their bilateral documents. The ISDA Clause Library Project is intending to introduce greater standardization in the form of certain terms by creating standard wording for terms that are routinely agreed. If necessary, there can be multiple versions of such standard form wording to allow for variations that firms feel necessary.

## 3.2 **The Clause Library**

3.2.1 The primary objective of the ISDA Clause Library Project is to build an industry-wide, foundational clause library for use with the ISDA Master Agreement. Clause libraries covering other ISDA documentation may be developed in future.

3.2.2 This clause library will be based on a robust and industry accepted clause taxonomy and will seek to cover not only Master Agreements put in place by market participants in the future, but also offer a way of classifying and identifying clause variants from their active legacy Master Agreement documentation portfolios.

3.2.3 A clause library will help to reduce legal risk by:

- Introducing industry validated clauses, which will reduce scope for error and problematic drafting;
- Improving the efficiency of negotiation by allowing lawyers and negotiators to focus on the most substantive and consequential clauses and issues; and
- Allowing for greater visibility in meeting business, regulatory and operational requirements as they arise.

3.2.4 A clause library will also have a number of operational benefits, including:

- A reduction in the time taken to negotiate an ISDA documentation and the “lawyering” of clauses, where clauses are subject to heavy negotiation for little discernible commercial benefit;
- Accelerating the development of a standard legal agreement data model; and
- Allowing downstream users to build consistent business processes based on such legal agreement data models.

3.2.5 Combined with the development of other ISDA technology initiatives such as the ISDA CDM and ISDA Create platform, the clause libraries will allow the development of an ecosystem of interoperable platforms to support business processes, such as regulatory capital calculations, liquidity reporting, collateral management, risk management and regulatory reporting – in a manner that is today constrained by the nuances and variances of the legal documentation.

## 3.3 **Phase One**

3.3.1 Phase one of the ISDA Clause Library Project will focus upon the development of a robust clause taxonomy for an initial list of in-scope clauses.

- 3.3.2 The specific proposed deliverables and scope for phase one of the ISDA Clause Library Project will be circulated ahead of the first meeting.
- 3.3.3 The clause library will, for the initial in-scope clauses, be a set library of business variants of a clause, as identified and selected through the LTWG, based on a number of defined architectural principles, designed to encourage the adoption of the clause libraries and ensuing standards, and successfully deliver the benefits envisaged as set out in paragraph 3.2 above
- 3.3.4 ISDA has instructed D2 Legal Technology (D2LT), a financial services legal data and legaltech consulting firm, to support ISDA and its members in delivering phase one of the ISDA Clause Library Project.
- 3.3.5 Phase one is expected to be completed by January 2019.
- 3.3.6 Further detail of ISDA’s legal technology strategy will be detailed in a whitepaper to be published in early 2019 by ISDA setting out a road-map, the approach, methodology, and the critical factors required for the adoption of the intended legal agreement data standards and the longer-term success of the ISDA Clause Library Project.
- 3.3.7 Following consultation with members, phase one may be extended in order to expand the clause taxonomy to capture additional clauses.
- 3.3.8 Phase two of the ISDA Clause Library Project will focus on building the clause library. We anticipate the phase two will commence in early 2019.

#### **4 MEMBER PARTICIPATION**

- 4.1 It is anticipated that working group calls will be held weekly for US / EU participants and fortnightly for Asia-Pacific participants, commencing the week of 22nd October 2018 for a duration of one hour. When required, materials will be issued in advance.
- 4.2 Ultimately, the success of the ISDA Clause Library Project will rely upon input and participation from ISDA members, ensuring alignment with member needs. The LTWG will ensure such alignment via member consultation. Members of the LTWG will be expected to:
- a) Assist with the selection and prioritization of in-scope clauses;
  - b) Provide sample clauses (or details of clauses/documentation) for the purposes of establishing the clause taxonomy and library; and
  - c) Regularly participate in the LTWG discussions, in order to develop the clause taxonomy and library.
- 4.3 After consideration of this memorandum, all interested ISDA members are invited to contact Ciarán McGonagle ([cmcgonagle@isda.org](mailto:cmcgonagle@isda.org)), Megan O’Flynn ([moflynn@isda.org](mailto:moflynn@isda.org)) or Erryan Abdul Samad ([eabdulsamad@isda.org](mailto:eabdulsamad@isda.org)) with any comments or questions.
- 4.4 In accordance with all ISDA projects, participation in this working group is conditional upon participants’ agreement not to use any part of this process for any anticompetitive purpose. All participating members must agree to engage with the working group in a manner that

comports with all applicable antitrust and competition laws and regulations, in line with guidelines that will be provided to the working group participants.

- 4.5 Following circulation of this memorandum, meeting invitations and corresponding materials will be distributed to all participating members.