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Efforts to Future-proof ISDA Documentation Important Step for Derivatives Smart Contracts, says New ISDA/Linklaters Whitepaper

NEW YORK, August 3, 2017 – Work currently under way to standardize and formalize certain clauses within International Swaps and Derivatives Association (ISDA) legal documents and definitions is an important pre-cursor to unlocking value in the derivatives market and realizing the cost and efficiency benefits of smart contracts and distributed ledger, according to a new whitepaper published today by ISDA and Linklaters.

The paper – *Smart Contracts and Distributed Ledger – A Legal Perspective* – outlines a possible near-term application of a smart contract for derivatives, and highlights the importance of a more formal representation of certain legal clauses and actions within the ISDA Definitions to enable them to be represented and executed via smart contract code.

Preparations are under way to update and future-proof ISDA documentation, starting with the 2006 Definitions for interest rate and currency derivatives. ISDA has also launched a new industry legal working group to focus specifically on smart contracts and distributed ledger. This is in conjunction with other work to develop common data and process standards to facilitate the interoperability of new technologies such as smart contracts.

“A lot of work has been done by ISDA and its members to unlock value in the derivatives market by developing the operational building blocks for smart contracts – and the common data and process hierarchy work led by ISDA is critical to that. This work complements our development of smart-contract and broader governance structures utilizing the existing and proven legal foundation that ISDA has developed over the past 30 years. This paper explores where a smart contract can be applied to automate the execution of certain specified actions, and also where a broader governance framework for non-operational legal agreements can be applied to future-proof existing product definitions and legal documents,” said Scott O’Malia, ISDA’s Chief Executive.

“The ISDA Master Agreement is possibly the most successful legal contract of all time, but the advent of smart contracts offers the possibility for it to become even more powerful. This paper is the first step in considering how that can come about,” said Paul Lewis, Derivatives and Structured Products Partner at Linklaters.

Key points in the paper include:

- There is a difference between smart contract code, which refers to code that is designed to execute certain tasks, and a smart legal contract, which refers to elements of a legal contract being represented and executed by software.
• Certain operational clauses within legal contracts lend themselves to being automated. Other non-operational clauses – for instance, the governing law of a contract – are less susceptible to being expressed in machine-readable code. Some legal clauses are subjective or require interpretation, which also creates challenges.

• A possible near-term application of a smart contract is for the legal contract to remain in natural legal language, but for certain actions to be automated via a smart contract.

• This would require those actions – for instance, payments and deliveries – to be represented in a more formal, standard way within the ISDA Definitions, enabling them to be read by machines.

• Transaction data could be held on a permissioned, private distributed ledger that would available to regulators. This would ensure there is a single, shared representation of each trade.

• Industry wide standards are required to ensure smart contracts are interoperable across firms and platforms. ISDA is working to develop these standards. The new ISDA Smart Contracts/DLT Legal Working Group will be discussing legal, documentation and regulatory issues on smart contracts going forward.

The full paper is available on the ISDA website.

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About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 875 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s web site: www.isda.org.

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About Linklaters
As one of the leading global law firms, Linklaters supports clients in achieving their objectives by solving their most complex and important legal issues. Our expertise and resources help clients to pursue opportunities and manage risk around the world.

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