

A Digital Future for Financial Markets

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Financial institutions are increasingly looking to technology to increase efficiencies and reduce costs, but scalable and interoperable automation is only achievable if the right foundations are in place first. ISDA, ISLA and several other associations last month sent a letter to regulators committing to develop those foundations¹.

The benefits of increased automation for market participants are clear. Digitization will promote the consistent creation, processing and aggregation of global financial data, bolstering regulatory oversight and compliance. Through the removal of redundancy and unnecessary complexity, increased digitization will increase efficiency and strengthen the operational resilience of market participants and financial markets infrastructure, reducing systemic risk and creating a safer and more robust global financial system.

None of this is possible without industry led development of essential data standards, and the distribution of these standards in digital formats to allow direct deployment within enhanced, automated and intelligent processes, systems and technology.

ISDA and ISLA share many of the same members. In a 2019 survey conducted by ISDA, members pointed to the continued use of bespoke legal documentation, inconsistent data representations, and a lack of digitized documentation and processes as among the main obstacles to reaching their desired future state for post-trade processing.

¹[\[Link to letter\]](#)

Many of these issues and challenges are common across the derivatives and securities lending markets, particularly following the introduction of the Securities Financing Transactions Regulation. It is for this reason that ISDA and ISLA have recently agreed to collaborate on the expansion of electronic contract opinions and application of the Common Domain Model (CDM) to help facilitate greater automation in the derivatives and securities lending markets. Both markets and sets of products stand to benefit from greater digitization of documentation, the implementation of common, interoperable industry standard models for financial transactions and processes, and the distribution of these standards through mutualized solutions and platforms.

Our members expect trade associations to play an important role in the development and promulgation of these new standards. The results of a 2020 ISDA survey indicate that over 95% of ISDA members support our strategy to enable innovation and automation in the financial markets, by developing standards, data models and digital formats for our documentation and content. In particular, a majority of members highlighted increased digitization of new and existing ISDA documents as providing an important foundation for facilitating adoption of these documents and associated standards, providing greater connectivity between documentation, systems and processes, and ensuring interoperability among different providers and solutions. Bespoke, paper-based documentation creates an obvious impediment to delivering our vision of a digital future. Trading, operations, legal, compliance and technology

functions within our member firms increasingly expect us to make industry documentation available in different formats to allow for easier integration within their systems.

ISDA's flagship digital offering is the 2020 ISDA Definitions, a revised and updated definitions booklet for use with interest rate derivatives. Alongside necessary updates and adjustments to take account of market evolution and global benchmark reform efforts, a key driver for this project is making the standardized interest rate definitions more user and technology friendly.

The 2020 ISDA Definitions will be produced in a digital format, allowing for the production and maintenance of a consolidated and up-to-date view of the definitions. This will avoid the need for users to compile paper or pdf copies of the main definitional booklet and up to 70 amending supplements in order to understand the terms that apply to their trades (as is the case with the current 2006 Definitions). ISDA will deliver the 2020 Definitions later this year through an online platform, increasing accessibility and incorporating various built-in functionalities and capabilities, such as hyperlinking and version control to provide a more user-friendly experience.

Expanding ISDA's digital offering across our suite of actively negotiated documentation requires enhanced standardization of those documents. Firms will always need to negotiate and customize documentation to address specific commercial, compliance, legal and operational risks. However, excessive customization can increase complexity and on-boarding times, while providing little or no commercial or legal benefit. A lack of standardization therefore gives rise to operational inefficiency, increases risk through unnecessary complexity and creates impediments to digitization.

In response, ISDA has developed the ISDA Clause Library. This tool effectively deconstructs the standard legal document and assigns meaning to the various

different obligations and events expressed within it. Using thousands of agreements and clause samples, we identified, defined and categorized the most commonly negotiated clauses within the ISDA Master Agreement and various credit support documents. Having established this framework, we created standard-form drafting options that are capable of achieving the vast majority of the most commonly negotiated outcomes within standard-form ISDA documentation. This standard-form wording is now available for use by members in their negotiations². The Clause Library will also be integrated within ISDA Create, ISDA's digital negotiation and execution platform, when the ISDA Master Agreement is added later this year. That will allow for more structured legal agreement data to be captured as part of the negotiation process.

Importantly, we developed the ISDA Clause Library by reference to substance and outcome, rather than form. Put simply, we focused on what a contractual provision intends to achieve, rather than the precise formulation of words used to achieve it. There is a clear opportunity to expand this initiative to cover additional forms of documentation across different types of financial transaction. For example, a cross-default clause within one contract may achieve the same effective outcome as an equivalent clause located within a different type of contract. There is no good reason to treat these clauses differently, irrespective of drafting nuance or the document in which the clause is located. A common, industry-wide taxonomy for financial contracts would be a powerful tool in dismantling institutional siloes and enhancing risk management and regulatory compliance across different products and functional areas.

Standardization and digitization of documentation is only half the battle. There is also a lack of common data and process standards, and little alignment between

² The ISDA Clause Library currently covers the ISDA Master Agreement. The Clause Library will be expanded to cover various ISDA credit support documents by the fourth quarter of 2020. More information is available [here](#)

these standards and the underlying documentation. Firms and infrastructure providers typically use their own unique set of representations for transaction events and processes. As a result, market infrastructure is inefficient and expensive.

ISDA and ISLA both support the development of common, interoperable industry standard models for financial transactions and processes. The CDM establishes a common, digital representation of derivatives trade events and actions that will increase automation and efficiency in the derivatives market. This model can be easily expanded to cover additional products and contracts as a means of encouraging further standardization across the financial markets. Indeed, ISLA is currently working to model and code specific securities financing transaction (SFT) components for inclusion in the CDM, creating greater alignment between derivatives and securities lending markets.

Refinement and expansion of these models will facilitate greater connectivity between contractual terms and the processes designed to implement important business and operational functions deriving from contracts, including netting and collateral enforceability, liquidity, and counterparty credit risk management. All of this will help move the industry towards more efficient, cost-effective and scalable payment, settlement, collateral management and regulatory processes, providing a robust foundation for further straight-through processing and automation of financial transactions.

Of course, not everything within a contract can be digitized and automated. However, the vast majority of derivatives transactions and SFTs rely heavily upon repetitive operational processes, such as valuations, calculations, payments and settlements. These terms are readily capable of being automated effectively and efficiently within a standardized, digital model.

Critical to the success of these efforts will be the extent to which market participants can easily access and benefit from these new standards. Fragmented and

duplicative distribution of digital offerings will inevitably result in incompatible platforms and solutions. This will increase inefficiency and cost to the market. We will therefore ensure that our standards and their digitized representations are made available in a way that promotes competition, encourages innovation and facilitates the development of mutualized technology solutions within our markets.

Over the past 30 years, ISDA and ISLA have a proven track record of addressing our members' problems with common, standardized solutions, such as the ISDA Master Agreement and the Global Master Securities Lending Agreement. Our two trade associations are perfectly placed and ready to lead and support our members in developing enhanced, digital standards and in delivering our vision of a digital future for our markets. In doing so, we will foster an environment for technological innovation and reduce costs for market participants. By removing complexity and strengthening the operational resilience of market participants, our initiatives will also contribute toward the reduction of systemic risk. All of this is consistent with ISDA's mission to build safer, more efficient markets.



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