



Financial Markets Law Committee (“FMLC”)

Finance and Technology Scoping Forum

Date: Thursday 8 November 2018

Time: 9.00am to 10.30am

Location: Katten Muchin Rosenman LLP, Paternoster House, 65 St Paul's Churchyard, London, EC4M 8AB

In Attendance:

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|-------------------------|--|
| Carolyn Jackson (Chair) | Katten Muchin Rosenman LLP |
| Maya Chilaeva | |
| Scott Farrell (dial in) | King & Wood Mallesons |
| Jonathan Gilmour | Travers Smith LLP |
| Andrew Godwin (dial in) | Melbourne Law School |
| Lorraine Johnston | Ashurst LLP |
| Suhail Khawaja | Wilmington Trust |
| Lewis Lee | CLS Services Ltd. |
| Catrin Lewis | The Law Society |
| Sarah Lewis | Cleary Gottlieb Steen & Hamilton LLP |
| Philippa List | Societe Generale |
| Vlad Maly | Morrison & Foerster LLP |
| Ciarán McGonagle | International Swaps and Derivatives Association, Inc. (“ISDA”) |
| Matthew Nyman | TruFin plc |
| Deborah Sabalot | Deborah A. Sabalot Regulatory Consulting |
| John Salmon | Hogan Lovells International LLP |
| Michael Sholem | Davis Polk & Wardwell LLP |
| Ian Stevens | CMS Cameron McKenna Nabarro Olswang LLP |
| John Taylor | Queen Mary University of London |
| Daniel Tunkel | Memery Crystal |
| Venessa Parekh | FMLC |
| Thomas Willett | FMLC |

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Regrets:

| | |
|-----------------|--------------------------------------|
| Nikita Aggarwal | |
| Kirsty Bell | Bank of England |
| Peter Chapman | Clifford Chance LLP |
| Raymond Cox QC | COMBAR |
| Cat Dankos | Herbert Smith Freehills LLP |
| Andrew Harvey | Global Financial Markets Association |
| Richard Hay | Linklaters LLP |
| Tessa Jones | FIA |
| Mark Kalderon | Freshfields Bruckhaus Deringer LLP |
| Ben Kingsley | Slaughter and May |
| Fiona Maclean | Latham & Watkins |
| Helen McGrath | Stripe |
| Adam Sanitt | Norton Rose Fulbright LLP |
| Kathleen Tyson | Granularity Ltd |

Minutes:

1. Introductions

- 1.1. Carolyn Jackson opened the meeting and delivered a brief introduction.

2. Administration: Scoping Exercise – Statutory Instruments under the Withdrawal Act and confirmation of the 2019 Forward Schedule¹

- 2.1. Venessa Parekh described to members the way in which the FMLC is conducting work on the draft statutory instruments (“SIs”) being pushed by HM Government under the European Union (Withdrawal) Act 2018 in relation to financial services. The FMLC has resolved to meet on an *ad hoc* basis should the volume of draft SIs and gravity of the legal complexities require the Committee’s full attention. In addition, the Secretariat will write to an existing Working Group or Scoping Forum on the topic of the SI to ask for their assistance and expertise in identifying any drafting inconsistencies or logical discrepancies.²
- 2.2. Attendees did not raise any issues in relation to the draft Forward Schedule of meetings for 2019. These meeting dates were therefore confirmed.

¹ Please see Appendix I below.

² Should you identify an issue of legal uncertainty in a statutory instrument before receiving correspondence from the Secretariat, please contact Venessa Parekh at: research@fmlc.org.

3. **Smart contracts and smart arbitration – challenges for the future (Mateja Durovic)**

- 3.1. Ms Jackson announced that, owing to illness, Dr Durovic was unable to attend the meeting and the Secretariat would arrange this presentation for a future Forum meeting.

4. **Whitepaper—Smart Derivatives Contracts: From Concept to Construction (Ciarán McGonagle and Scott Farrell)**³

- 4.1. Ciarán McGonagle introduced a whitepaper published by ISDA and King & Wood Mallesons entitled *Smart Derivatives Contracts: From Concept to Construction* (the “**Whitepaper**”). He explained that it builds upon work initiated in a previous ISDA paper, published with Linklaters LPP in August 2017, in which internal and external models of smart legal contracts were defined (in the internal model, the smart clause sits within the text of the contract; in the external model, the coded provisions remain separate to the legal contract) and an exploration of the way in which technological developments might be applied to derivatives documentation was initiated.⁴ The recent Whitepaper takes these concepts a step further by considering the practical implications of attempting to utilise smart legal contracts within ISDA documentary standards. Questions which the Whitepaper attempts to answer include how lawyers might validate the language within such contracts without the requisite technical knowledge of code and how this framework might work within the context of the ISDA Common Domain Model (“**CDM**”).
- 4.2. Scott Farrell explained that the paper focuses on smart legal contracts using the internal model i.e. provisions which can be performed automatically are included in the legal contract, but are rewritten in a more formal code than the current natural language form. The Whitepaper considers, in particular, smart derivative contracts. Mr Farrell explained that the paper considers the manner in which the regulatory, legal, commercial and technological standards which apply in the derivatives markets will have to be extended to smart derivatives contracts. The ISDA CDM will play a fundamental role in ensuring that smart derivatives contracts achieve compatibility with these standards. This would have to be explored further by collaborating with people from different backgrounds.
- 4.3. Mr Farrell observed that the Whitepaper uncovers two areas of complexity in relation to smart derivatives contracts. First, Mr Farrell emphasised that not every element of a contract could—and should—be automated. Apart from technical ability, efficiency would

³ ISDA, King & Wood Mallesons. (2018) *Whitepaper Smart Derivatives Contracts: From Concept to Construction*, available at: <https://www.isda.org/a/CHvEE/Smart-Derivatives-Contracts-From-Concept-to-Construction-Oct-2018.pdf>.

⁴ ISDA, Linklaters. (2017) *Whitepaper Smart Contracts and Distributed Ledger – A Legal Perspective*, available at: <https://www.isda.org/a/6EKDE/smart-contracts-and-distributed-ledger-a-legal-perspective.pdf>.

also be an important consideration. He highlighted that identifying the right provisions to automate would be essential to this undertaking as would determining which of these would give the most efficient result. The point of smart contracts is not to solve all problems but to enhance the effectiveness of a lawyer's work. The second question was about the means by which smart clauses would be validated as parties would be likely to desire confirmation that the new form of contracts has the same legal effect.

- 4.4. Mr Farrell summarised the last section of the Whitepaper on “constructing a smart derivatives contract”, and explained that this depicts what smart derivatives contracts could look like when expressed in language, and is intended to show what might be done. This Whitepaper, however, does not form the end result, but presents itself more as a roadmap to indicate areas of complexity.
- 4.5. To conclude their presentation, Mr McGonagle noted that the focus of his work at the moment is on identifying how new technologies might impact existing legal and documentation standards given that the development of regulatory standards in this area is at quite an early stage. Mr McGonagle emphasised the need for collaboration and observed that further conversations with the technology community would be necessary. Given the complexity of derivatives contracts, work needs to be done to explore how technology might impact transaction documentation at multiple levels, including payments, netting, and default provisions.
- 4.6. One participant asked when the first template for a smart derivatives contract would be ready. The speakers stated that it would not be available soon as a lot of work remains. Equally, Mr McGonagle observed that, as technology develops rapidly, the form of smart contracts could change too. One participant recommended that discussions be held with insolvency practitioners in the construction of smart derivatives contracts.
- 4.7. Lastly, one participant raised the question of whether a more in-depth project was needed to examine how smart contracts would impact the ordinary elements of a contract such as formation, frustration, and mistake. Another member queried, in response, how the process of transitioning to the use of smart derivatives contracts would be different to previous transitions driven by technology, such as contracts sent by email. Participants considered that while perhaps the same principles would apply, their implementation would have to evolve.

5. Any other business

- 5.1. No other business was raised.

Scoping Exercise—Statutory Instruments under the Withdrawal Act



Venessa Parekh, Research Manager

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Recent Developments...

- The European Union (Withdrawal) Act 2018 (“**Withdrawal Act**”) will repeal the European Communities Act 1972 as of Exit Day, copy into the domestic framework all directly applicable E.U. law which is in operation on Exit Day, and give HM Government the ability to modify and adapt this “retained” law as necessary to resolve any deficiencies. This last stated aim of the Withdrawal Act will be fulfilled by means of statutory instruments (“**SIs**”) published by relevant ministries.
- HM Treasury has announced it will approximately 70 pieces of secondary legislation under the European Union (Withdrawal) Act 2018 in relation to the financial services. As the end of the Article 50 notice period rapidly approaches, the timeline for any comment or consultation on these drafts is likely to be compressed.

The FMLC's Response



- In its meeting on 31 May 2018, the FMLC resolved to meet on an *ad hoc* basis—in addition to its scheduled bimonthly meetings—should the volume of the draft statutory instruments and gravity of the legal complexities require the Committee's full attention.
- The Secretariat organised meetings on 29 June 2018 and 3 August 2018 amongst leading organisations in the City to discuss a coordinated response to HM Treasury's announcement.
- As the statutory instruments are published, the FMLC hopes to be able to rely on and amplify its Radar function to identify legal uncertainties arising from the them.

FMLC radar function

- Currently, the FMLC identifies relevant issues of uncertainty through the radar function.
- New issues of legal uncertainty on which the FMLC can undertake work are raised in Scoping Forum meetings, bilateral radar meetings with Joanna Perkins (FMLC CEO) and during monthly Patron and Stakeholder relationship calls with members of the Secretariat.
- For the purposes of analysing the raft of secondary “reception” instruments, however, the Secretariat proposes to expand its Radar function by reaching out to pre-existing working groups and scoping forums on an *ad hoc* basis to request their assistance in assessing legal risks, identifying priorities and selecting issues in relation to the draft SIs.



Next Steps...

- Once an SI is published, the Secretariat will write to an existing Working Group on the topic of the SI or, where such a group does not exist or where the SI covers a significant piece of financial markets legislation, to the relevant Scoping Forum to ask for their help and expertise in identifying any drafting inconsistencies or logical discrepancies.
- Scoping Forum members are requested to indicate any areas of uncertainty on which they think the FMLC might usefully contribute.
- Owing to the shorter timescale for review, the Secretariat would be grateful to receive quick bullet points if that is easier.
- Needless to say, if you don't hear from us but spot a legal uncertainty in an SI, please do get in touch anyway!

Points to note

Any work the FMLC undertakes on the SIs will continue to follow the principles and processes set out in its constitution. These include:

- The FMLC does not comment on or seek to influence matters of policy. Issues relating to policy rather than solely to legal uncertainty will not be examined.
- The FMLC is dedicated to impartial consensus
- Scoping Forums have no *vires* to initiate projects or pass resolutions affecting the FMLC. Substantive issues of legal uncertainty are proposed by the Secretariat to the FMLC as a topic which may require further action.
- Any response on the SIs will be submitted to the entire Committee for review to ensure accuracy, objectivity and impartiality.

Confirmation of 2019 forward schedule

Tuesday 5 February

9.00am to 10.30am (U.K.)

8.00pm to 9.30pm (Australia)

Tuesday 7 May

2.00pm to 3.30pm (U.K.)

9.00am to 10.30am (U.S.)

Tuesday 6 August

9.00am to 10.30am (U.K.)

6.00pm to 7.30pm (Australia)

Tuesday 5 November

2.00pm to 3.30pm (U.K.)

9.00am to 10.30am (U.S.)

