



## Financial Markets Law Committee (“FMLC”)

### Finance and Technology Scoping Forum

Date: Tuesday 7 May 2019

Time: 2.00 pm to 3.30 pm

Location: Simmons & Simmons LLP - CityPoint, 1 Ropemaker St, London, EC2Y 9SS

#### **In Attendance:**

Angus McLean (chair)	Simmons & Simmons LLP
Cat Dankos	Herbert Smith Freehills LLP
Jonathan Gilmour	Travers Smith LLP
Monica Gogna	Dechert LLP
Andrew Harvey	GFMA – Global Financial Markets Association
Carolyn Jackson	Katten Katten Muchin Rosenman UK LLP
Lorraine Johnston	Ashurst LLP
Lewis Lee	CIs Group
Sarah Lewis	Cleary Gottlieb Steen & Hamilton LLP
Philippa List	Societe Generale
Mark Kalderon	Freshfields Bruckhaus Deringer LLP
Matthew Nyman	TruFin Plc
Michael Sholem	CWT Cadwalader, Wickersham & Taft LLP
Ian Stevens	CMS Cameron McKenna Nabarro Olswang LLP
John Taylor	Queen Mary University of London
Virgilio Diniz	FMLC

#### **Regrets:**

Nikita Aggarwal	University of Oxford
Antony Beaves	Bank of England
Chris Glennie	Bank of England
Suhail Khawaja	Wilmington Trust London
Ben Kingsley	Slaughter and May LLP
Helen McGrath	Stripe
James Reynolds	Law Society
Simon Toms	Allen & Overy LLP
Kathleen Tyson	Granularity Ltd

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## Minutes:

### 1. **Introductions**

1.1. The Chair opened the meeting and asked attendees to introduce themselves.

### 2. **Administration: FMLC in numbers (Virgilio Diniz)**

2.1. Mr Diniz provided attendees with an update on numbers relating to the performance and activities of the FMLC in 2018.

### 3. **Introductory remarks on legal uncertainties concerning the impact of smart contracts on the ordinary elements and functioning of a contract such as formation, frustration and mistake (Carolyn Jackson)**

3.1. Ms Jackson noted the importance of a debate about whether and how doctrines giving rise to legal uncertainty, such as formation, frustration and mistake, will apply to smart contracts, which are intending to be automatic and self-executing. In this regard, one attendee pointed out that the discussion surrounding smart contracts could be considered within two models, the external model, whereby the code is not a part of the legal agreement and is merely one way in which the parties may perform their rights and obligations under the agreement, and the internal model, which is represented by a computer code, whereby will be part of the contract and would have legal effect.

3.2. Ms Jackson stressed that there is no specific definition of smart contracts. An attendee drew attention to efforts amongst working groups, such as the Law Tech Delivery Panel, from the U.K. Jurisdiction Taskforce Law Society, by which the status of crypto-assets, distributed ledger technology and smart contracts under English private law have been discussed and subject of [consultation](#).<sup>1</sup>

3.3. In the discussion that followed, one attendee stressed legal uncertainties might arise in regard to the liability of the code drafters in cases where there is a discrepancy in the outcome of the contract performance.

3.4. The Chair asked attendees whether they would like to propose further analysis on this to the FMLC. Attendees agreed that an analysis of the Law Tech Panel consultation paper on the status of crypto-assets, distributed ledger technology and smart contracts, should be

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<sup>1</sup> The U.K. Jurisdiction Taskforce consultation on Crypto-assets, DLT and smart contracts is also available at: <https://www.lawsociety.org.uk/news/stories/cryptoassets-dlt-and-smart-contracts-ukjt-consultation/>

undertaken to identify the relevant legal issues. Attendees observed that there was a question of taxonomy—the question of how to define and categorise smart contracts—to which the FMLC could make a valuable contribution.

**4. Introductory remarks on [Smart Derivative Contracts](#) (Ciaran McGonagle);**

4.1. Mr McGonagle highlighted that smart derivatives contracts must consider and be consistent with different legal, regulatory, commercial and technology standards that apply to derivatives trading and smart contracts.

4.2. Mr. McGonagle explained that developers of smart derivatives contracts should consider two key principles. The first one is that automation must be effective (i.e the translation of legal text into computer code must not lose the meaning of the original text) which will require an interdisciplinary approach, among lawyers, computer scientists and banking practitioners. The second is that automation should be efficient (i.e., there must be sufficient benefit to automation).

4.3. Mr McGonagle presented the Legal Guidelines to Smart Derivatives Contracts, prepared and published by the International Swaps and Derivatives Association “**ISDA**”. The document sets out some of the areas of complexity that exist within ISDA documentation and explores some issues for technology developers to consider as they apply technology solutions to derivatives trading. He noted that much of the operational detail of payments and deliveries can be found in the transaction confirmation and product definitions ( i.e. the economic terms and payment mechanics of the particular derivatives product), but it is not sufficient just to automate the operational aspects of the contract found in the economic terms; the broader contractual relationship must also be taken into account in order to capture the complexity that can affect a party’s ability to perform its obligation or assert its rights and in order to support key operations such as netting. In this regard, one member questioned whether automating performance was being looked at in the smart derivatives contract context, as well as some form of representation for transaction confirmation. Mr. McGonagle responded that ISDA was considering both models in its analysis but that legal and contractual issues were more likely to arise where terms within the contract are represented in code.

**5. Transposition of the AMLD5 – HMT Consultation (Matthew Nyman);**

5.1. Mr Nyman introduced a [Consultation document](#) by HMT which considers the eventual implementation in the U.K. of Directive (EU) 2018/843 on the prevention of the use of the

financial system for the purposes of money laundering or terrorist financing (the “Fifth Anti-Money Laundering Directive” or “AMLD5”).

- 5.2. Mr. Nyman began his remarks by stating that, in regards to the FinTech aspects of the implementation of the AMLD5, the directive introduces regulation for two new services/activities, which are: providers engaged in exchange services between virtual currencies and fiat currencies, and custodian wallet providers (where, instead of the users holding the private keys for their virtual currency, those private keys are held for them).
- 5.3. Mr. Nyman outlined the 15 May Consultation Paper by HMT on the implementation of AMLD5 which would extend AML legislation to cover five additional areas: 1) crypto-to-crypto exchange service providers; 2) peer-to-peer exchange service providers; 3) crypto-assets automatic teller providers; 4) issuances of new crypto-assets, such as ICOs; and 5) publication of open source software (which includes but is not limited to non-custodian wallet software and other crypto-asset related software).
- 5.4. Mr. Nyman also stated that there are not specific issues of legal uncertainty in the consultation although the definitions of a crypto-currency and of a custodian wallet provider are not completely clear. He pointed out, that, for example, in regards to virtual crypto-currency, there are different definitions among the Financial Conduct Authority (“FCA”), the Crypto-asset Taskforce and HMT, and it is not clear if Distributor Ledger Technology (“DLT”) is involved in the HMT definition within its consultation.
- 5.5. Lastly, Mr. Nyman noted that there is a paradigm shift in that lawyers now need to understand what code is used to create an asset, given the main difficulty to separate the code from the asset.

## **6. Any other business**

- 6.1. In the last section of the meeting, Mr. John Taylor made introductory remarks on the legal aspects of the transaction management in relation to a new digital product known as the Digital Ledger Payment Commitment (“DLTC”)<sup>2</sup> that has been designed by a Working Group of bankers, fintech experts and lawyers, including John. He stressed that there are concerns from the technological and banking perspective in regards to transaction management as to ensuring a payment commitment in digital form is valid. He observed that it may be challenging for some contracting parties to find a governing law which is

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<sup>2</sup> Details of DLPC are available at: <https://baft.org/docs/default-source/default-document-library/baft-dlpc-business-best-practices-proposed-specifications-for-trial-use-final.pdf?sfvrsn=2> and <https://baft.org/docs/default-source/default-document-library/baft-dlpc-technical-best-practices-proposed-specifications-for-trial-use-final.pdf?sfvrsn=2>

sufficiently advanced to create certainty around digital payments. He gave the example of the statutory law of the state of Delaware.