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ISDA Publishes Digital Asset Derivatives Definitions and Accompanying Whitepaper Addressing Netting and Collateral Issues



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On January 26, the International Swaps and Derivatives Association, Inc. (“ISDA”) published the [ISDA Digital Asset Derivatives Definitions](#) (the “Definitions”). The Definitions are intended for documenting privately negotiated derivatives transactions referencing digital assets based on the distributed ledger or similar technology using standard ISDA documentation architecture. The coverage of this initial version of the Definitions is limited to non-deliverable forwards and options on Bitcoin and Ether. The Definitions provide standard settlement, valuation, disruption event and termination terms and are designed to allow for future updates. It is expected that the coverage of the Definitions will be expanded to other types of derivative transactions and other classes of digital assets.

The recent collapse of the algorithmic stablecoin TerraUSD and related Luna token, as well as the [bankruptcies](#) of Three Arrows Capital, Voyager Digital, [Celsius Network](#), BlockFi and [FTX](#) that resulted in billions of dollars in losses to investors, raised a number of novel legal and counterparty credit risk management issues specific to digital assets. Since the Definitions do not cover those issues, ISDA decided to publish two whitepapers intended to help market participants to better understand and address them. The first whitepaper, titled “[Navigating Bankruptcy In Digital Asset Markets: Netting and Collateral Enforceability](#),” which was released simultaneously with the Definitions, focuses on issues relating to counterparty risk management through close-out netting and taking of collateral.

The whitepaper argues that derivatives transactions referencing digital assets present unique challenges when it comes to bankruptcy proceedings due to the decentralized and often global nature of the digital asset markets. It explains that enforceability of close-out netting depends on bankruptcy and insolvency law in the relevant jurisdictions. To address legal certainty of close-out netting, ISDA intends to expand coverage of its close-out netting opinion library to include digital

assets. Additionally, the whitepaper analyzes the challenges of using digital assets as collateral, including perfection of security interest, enforcement and collateral documentation issues. It recommends further collaboration between technology developers, legal scholars, regulators, and market participants to resolve existing issues and develop more effective and efficient ways to implement digital-asset-based collateral solutions.

The second whitepaper that is expected to be published later in the first quarter of 2023 will focus on issues related to holding digital assets through intermediaries.
