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ISDA Publishes Digital Asset Derivatives Definitions

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Digital assets have experienced enormous growth over the recent years, including in the derivatives space, with certain assets such as Bitcoin and Ether having daily trading volumes that rival some of the more traditional products.¹ Despite the recent collapse of the crypto exchange FTX and the knock-on effects on the crypto market continuing to make headlines, digital assets remain an area of interest among market participants and investors.

To promote the transparency and increase liquidity of digital assets derivative transactions, as well as improve contract standardization in this area, on 26 January 2023, International Swaps and Derivatives Association, Inc. ("ISDA") published the Digital Asset Derivatives Definitions (a copy of which is available on the ISDA website <https://www.isda.org/>), which are intended for use in confirmations evidencing agreements of individual digital asset derivative transactions governed by agreements such as the 1992 ISDA Master Agreement or the ISDA 2002 Master Agreement published by ISDA.

ISDA published this new standard documentation alongside a whitepaper that addresses some of the legal issues raised by the collapse of FTX and others, including ownership and intermediation of customer assets in the crypto space. The whitepaper is the first of two publications. The first paper focuses on the importance of close-out netting and collateral arrangements for derivatives referencing digital assets and identifies several areas of focus for policymakers and market participants to ensure greater certainty. This includes use of standardized contractual frameworks like the ISDA Digital Asset Derivatives Definitions and further legal clarity from national authorities on the property status of digital assets. The second paper, due for publication later in the first quarter of 2023, will focus on issues related to customer assets held with intermediaries.

The definitions are designed for use by market participants in over-the-counter non-deliverable digital asset forwards and options where the reference asset is Bitcoin or Ether. However, these definitions can serve as a useful base for other derivatives transactions or other products referencing digital assets, such as repos, bonds, or loans.

The Digital Asset Derivatives Definitions cover, among other things, the following areas:

- *Disruption events and fallbacks* – similar to other asset classes, digital assets could be subject to certain events that could interrupt or disrupt the functioning of digital asset derivatives transactions (e.g., they may impact the valuation, impede or prevent settlement or the posting of collateral, and/or jeopardise the overall trading relationship);
- *Forks* – digital assets may be subject to changes in the underlying technology that may fundamentally alter the nature or functionality of the digital asset for the purposes of any

derivative transaction. Forks (i.e., splits in the blockchain network) are one of the examples of this type of changes; and

- *Valuation* – the Digital Asset Derivatives Definitions cover various aspects of valuation of digital assets derivative transactions such as determining the appropriate valuation source and valuation methodologies.

The publication by the ISDA of the Digital Asset Derivatives Definitions is hoped to increase transparency and liquidity in the digital assets market by facilitating price discovery and allowing market participants to hedge risk more effectively, whilst also introducing contractual standards which are central to the development of a safe, efficient digital asset derivatives market.

We understand that in future ISDA is looking to expand the Digital Assets Derivatives Definitions to cater for other digital assets and other derivative products.



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¹ For example, in June 2021, trading volumes in digital asset derivatives across all trading venues amounted to \$3.2 trillion. CryptoCompare, Exchange Review, June 2021, www.cryptocompare.com/media/37748193/cryptocompare-exchange-review-2021-06.pdf.