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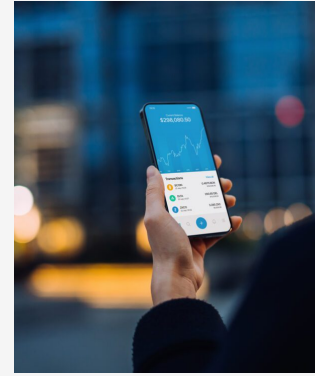# ISDA publishes digital asset derivatives definitions

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The International Swaps and Derivatives Association, Inc. (ISDA) has published new documents pertaining to the trading of digital asset derivatives, along with a whitepaper addressing legal issues raised by the recent bankruptcies of major crypto exchanges and crypto market participants (e.g, Three Arrows Capital, Celsius and Genesis). The recent publication of the ISDA Digital Asset Derivatives Definitions (the Definitions) and the whitepaper is a significant development for Canadian digital asset market participants, and will be welcomed by those who trade in digital asset derivatives. The Definitions and whitepaper seek to standardize derivatives trading documentation and contribute to efforts to clarify the close-out netting and collateral treatment of digital assets.

ISDA expects to publish a second whitepaper during the first quarter of 2023, addressing issues relating to customer digital assets held with intermediaries. ISDA is also expected to begin work in 2023 to update netting opinions in relevant jurisdictions to include reference to digital assets.

ISDA has designed the Definitions for use by market participants in OTC non-deliverable digital asset forwards and options that reference the two largest cryptocurrencies: Bitcoin (BTC) and Ether (ETH). The Definitions may be expanded in the future to cover additional digital assets (e.g., tokenized securities and other digital assets created using distributed ledger technology). The Definitions may be used in confirmations for digital asset transactions governed by an ISDA Master Agreement. Further, the Definitions include a template form of confirmation.

The Definitions contain default provisions addressing the following key terms of a digital asset non-deliverable forward or option transaction:

- Option premium payment terms.

- Cash settlement terms based on customary forward and option settlement calculations tied to the settlement price and the forward or strike price of the underlying reference digital asset.

- Valuation and settlement dates and related disruption fallbacks.

- Settlement price sources as set forth in a Price Source Matrix containing standardized information relating to certain BTC and ETH price sources (e.g., certain CME Group published price sources), and

- Disruption event fallback provisions, including "fork disruptions" which are unique to blockchain digital assets[1]

Unlike traditional securities and other reference assets underlying common OTC derivatives, because BTC and ETH are native to a blockchain, they are susceptible to "forks".[2] To address the uniqueness of blockchain-based digital assets and the possibility of a fork, the Definitions include fork disruption fallback provisions which are meant to allocate the risk of a fork in BTC or ETH's underlying protocol.

The default fork disruption fallback provisions provide for, at a high level, the ability for the specified counterparty to designate when a disruption event (a Fork Disruption Event) has occurred. A Fork Disruption Event occurs when a blockchain is forked and the settlement source provider has *not* determined (i) a single continuation price for the successor assets, or (ii) for non-composite price sources, that one of the reference assets is the continuation successor asset (a Price Source Provider Determination Condition).

In the case of a Fork Disruption Event, counterparties may specify which of the following fallbacks will apply:

- *Calculation Agent Fork Adjustment*: adjustment to the terms of the transaction by the Calculation Agent to clarify which reference asset(s) and settlement price source the transactions will follow (or early termination if continuation is not commercially reasonable)

- *Fork Termination Event*: early termination of the transaction

If the Price Source Provider Determination Condition *is* satisfied but, as a result of the fork, the reference asset or settlement source price is inconsistent with the determination of the settlement source provider, the Calculation Agent must propose amendments to the terms of the transaction to reflect the settlement source provider's determination. Any such amendments must be made in a prompt fashion.

In addition to the publication of the Definitions, we expect 2023 to bring further developments to the digital asset derivatives market.

Osler intends to provide updates as this complex area evolves; so please stay tuned for future articles on ISDA's digital asset derivatives documentation and the digital asset derivatives market.

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[1] Other disruptions include price source, hedging and change in law disruptions.

[2] "Forks" occur when a change is made to the blockchain's protocol that splits the chain and produces a second blockchain that shares all of the original blockchain's history, but proceeds in a new direction.