

## Launch of the ISLA Clause Taxonomy &amp; Library Project and Associated Working Group

## 1. INTRODUCTION

- 1.1. Over the past thirty years, ISLA has worked with their members to produce and maintain a documentation framework to support the growth of the securities lending industry. This has been achieved in part through the development of the Global Master Securities Lending Agreement (GMSLA) and corresponding documentation, such as various addendums and annexes. Together with items such as netting opinions, this framework has provided legal certainty, clarity and efficiency for securities lending market participants.
- 1.2. Whereas the core terms of such documentation have largely remained, there has been an ever increasing number of variants of its negotiated clauses. This has increased the time taken for negotiation and onboarding of new client relationships. Where these variances have different commercial and operational effects, this has led to a need for bespoke business processes to monitor and respond to the contractual obligations in place. The rapidly evolving regulatory landscape that has emerged since the events of the financial crisis has put further strain on the processes and systems reliant on specific GMSLA terms.
- 1.3. These challenges are highlighted in the sentiments expressed in industry Master Agreement Management surveys published by D2 Legal Technology (D2LT). These surveys have highlighted a number of areas, notably an inefficient negotiation process, inability to accurately digitise legal agreements, difficulty in creating legal agreement data repositories due to the high degree of customisation across agreements, and all the issues that consequently arise from not knowing exactly what has been agreed within the documentation. In particular, 89% of respondents felt that there was “a hugely powerful argument that industry [driven] standardisation would be beneficial” and that the “lack of even internal, never mind industry clause libraries means that variations in language makes digitisation and legal agreement management problematic.”
- 1.4. These trends have led to a desire amongst many ISLA members to move to a more standardised approach to GMSLA Schedule clauses, including exploration of various “LegalTech” solutions.
- 1.5. The International Swaps and Derivatives Association (ISDA) have recently completed a project engaging D2LT to create a foundational Clause Taxonomy and Library for the ISDA Master Agreement and related Credit Support Arrangements. This is now enabling ISDA members to negotiate schedule clauses using standard form drafting for each business outcome leading to a safer and more efficient market for derivative market participants<sup>1</sup>, as well as the start of many further benefits that document digitisation offers.
- 1.6. On 29 July 2020, and working in collaboration with ISDA, ICMA, LBMA, UK Finance, Association of German Banks, AFMA and the International Islamic Financial Market, ISLA submitted a joint letter to the Bank for International Settlements, the Financial Stability Board, and the International Organisation of Securities Commissions asserting its commitment to defining and promoting the development of a digital future for financial markets.
- 1.7. The joint letter sets out a series of principles and objectives aimed at promoting the development, distribution and adoption of digital standards within financial markets, creating the foundation for transformational change in our respective industries. The full letter may be found [here](#).

- 1.8. Consistent with the principles and objectives that were set out in this letter of Standardisation, Digitisation and Distribution, ISLA have set an initial objective to develop and build an industry-wide foundational clause taxonomy and library for the schedule to the GMSLA (the ISLA Clause Taxonomy and Library Project).
- 1.9. ISLA is now establishing a Clause Taxonomy and Library Working Group (CTLWG) to explore and discuss opportunities for further standardisation of ISLA documentation and the further development of LegalTech solutions (such as the Common Domain Model (CDM)).
- 1.10. This project will leverage and refine the approach which was developed for ISDA as this will lead to a robust solution for the GMSLA in a way which is most efficient for ISLA members.
- 1.11. ISLA are pleased to appoint ISLA member D2 Legal Technology (D2LT) to assist us with this work. D2 Legal Technology are an award-winning financial services legal data and LegalTech consulting firm, and were the consulting partner for ISDA for the successful delivery of their project as referred to above.
- 1.12. This memorandum has been prepared with D2LT and explores current market challenges in relation to the variations in clause language and the issues that arise as a consequence. It provides an overview of the ISLA Clause Taxonomy and Library Project and details of the CTLWG that is being set up to support this work.
- 1.13. After consideration of this memorandum, all interested ISLA members are invited to contact Tina Baker ([tinajbaker@isla.co.uk](mailto:tinajbaker@isla.co.uk)), David Shone ([david.shone@isla.co.uk](mailto:david.shone@isla.co.uk)) or Akber Dattoo ([akber@d2legaltech.com](mailto:akber@d2legaltech.com)) with any comments or questions.
- 1.14. **This memorandum is intended for general guidance to facilitate further discussion of these issues among members. It does not constitute legal advice. Members should seek specific advice from their own internal and/or external legal advisers in relation to the circumstances of individual matters or cases where they may wish to consider the use/implementation of this project with regards to their ISLA documentation and systems.**

## 2. THE CLAUSE TAXONOMY AND LIBRARY WORKING GROUP

- 2.1. Despite a plethora of standard legal documents published for industry use, many documents are still customised between transacting parties. This presents a number of issues for market participants:
  - The maintenance of customised templates and negotiation guides can result in protracted negotiation and client onboarding where commercial positions and preferred drafting options conflict with those maintained by their counterparties.
  - The drafting of bespoke contractual provisions can prevent certain data within the contract from being easily captured and recorded using electronic data capture systems requiring certain data to be recorded and verified manually.
  - Where contractual provisions are customised, a lack of common data and metadata standards may impede interoperability, reducing the efficiency and accuracy of systems designed to monitor, for example, netting enforceability, liquidity, credit risk and collateral management.
  - A lack of common standards around how more formal representations of existing contractual provisions might be introduced across ISLA documentation may present obstacles to the adoption of new technology, such as distributed ledger and smart contracts.

- 2.2. Increased standardisation and digitisation will drive more accurate data capture and more efficient trade processing, both within firms and across the market. A greater emphasis on standardisation and digitisation will also support the development of technology-enabled contract delivery solutions which will facilitate more efficient and cost-effective client onboarding. Finally, the adoption of common standards will drive development and adoption of technology by providing clear product and legal specifications for market participants and technology providers to build towards.
- 2.3. The extent to which the securities lending market will benefit from the increased use of technology such as DLT and smart contracts is likely to be dependent both on the establishment of foundational processes, data and documentation standards and the extent to which areas of legal and regulatory uncertainty in its use can be identified and resolved.
- 2.4. However, without enhanced legal agreement documentation standards, it will not be possible to truly unlock the business value offered by such standards and technologies. ISLA has therefore commenced work on a number of projects aimed at developing and promoting common legal and documentation standards as well as to provide members with platforms to facilitate this.
- 2.5. ISLA has created the ISLA Clause Taxonomy and Library Working Group (CTLWG) to explore and discuss opportunities for further standardisation of ISLA documentation and to support the delivery of ISLA's legal technology strategy.
- 2.6. The CTLWG will complement the work of the ISLA Digital Working Group, which focusses on digital and regtech matters related to securities lending.
- 2.7. A separate CDM design group is working on further developing the CDM for the securities lending industry, introducing a common set of process and data standards to increase automation and efficiency in the securities lending markets and upon which smart securities lending contracts can be developed.

### 3. THE ISLA CLAUSE TAXONOMY AND LIBRARY PROJECT

#### 3.1. Standardisation

- 3.1.1. The current lack of standardisation in ISLA documentation gives rise to operational inefficiencies, unsustainable costs and legal and operational risk.
- 3.1.2. For example, the Schedule to the Global Master Securities Lending Agreement (GMSLA) continues to be a routinely and heavily negotiated document. This presents a number of challenges to firms:
  - Firms typically maintain their own customised templates and negotiation guides which set out a menu of negotiated positions that their lawyers can choose from when negotiating a GMSLA. These positions may conflict or be incompatible with those maintained by other firms, leading to lengthy contract negotiation. The client onboarding process can therefore consume a considerable amount of time and resource.
  - Bespoke provisions often hinder the capture of legal agreement data from being accurate and precise, requiring manual and error-prone processes.
  - Firms may have multiple systems which are either intended to capture contracts negotiated by different desks/businesses or which are designed to capture different aspects of the contract (netting enforceability, liquidity, credit risk etc.). Where negotiated provisions are bespoke, interoperability between these systems is often impeded.

3.1.3. To address these challenges, ISLA will shortly commence a new project (the ISLA Clause Taxonomy and Library Project) to identify provisions within the schedule to the GMSLA that might benefit from further standardisation. As part of this analysis, ISLA will identify opportunities for creating standard form drafting options in respect of these provisions.

3.1.4. Increased standardisation of clause language will:

- Provide the capacity to facilitate change, improve processes and use of documentation and data management technology whilst fully understanding the true impact and costs of particular clause wording.
- Promote the development of standardised and categorised legal agreement reference data governance across the industry; and
- Provide firms with better visibility and control over the documentation terms affected by certain events, facilitating a more automated response to the increasing regulatory requirements to report on GMSLA clauses such as events of default and automatic early termination.

3.1.5. It is important to note that clause standardisation does not mean standardisation of, or restrictions on, the terms firms may agree in their bilateral documents. Standardisation of clause language does mean standardising the way in which firms agree terms in their bilateral documents. The ISLA Clause Taxonomy and Library Project is intending to introduce greater standardisation in the form of certain terms by creating standard wording for terms that are routinely agreed. If necessary, there can be multiple versions of such standard form wording to allow for variations that firms feel necessary.

3.2. The Clause Taxonomy and Library

3.2.1. The primary objective of the ISLA Clause Taxonomy and Library Project is to build an industry-wide, foundational clause library for use with the GMSLA. The clause library will be based on a robust and industry accepted clause taxonomy. Clause libraries covering legacy ISLA documentation may be developed in future.

3.2.2. A clause library will help to reduce legal risk by:

- Introducing industry validated clauses, which will reduce scope for error and problematic drafting.
- Improving the efficiency of negotiation by allowing lawyers and negotiators to focus on the most substantive and consequential clauses and issues; and
- Allowing for greater visibility in meeting business, regulatory and operational requirements as they arise.

3.2.3. A clause library will also have a number of operational benefits, including:

- A reduction in the time taken to negotiate securities lending documentation and the “lawyering” of clauses, where clauses are subject to heavy negotiation for little discernible commercial benefit.
- Accelerating the development of a standard legal agreement data model; and
- Allowing downstream users to build consistent business processes based on such legal agreement data models.

3.2.4. Combined with the development of other ISLA technology initiatives such as the CDM, the clause libraries will allow the development of an ecosystem of interoperable platforms to support business

processes, such as regulatory capital calculations, liquidity reporting, collateral management, risk management and regulatory reporting – in a manner that is today constrained by the nuances and variances of the legal documentation.

### 3.3. Phase One

- 3.3.1. Phase one of the ISLA Clause Taxonomy and Library Project will focus upon the development of a robust clause taxonomy for the initial list of in-scope agreement types: GMSLA Security Interest Over Collateral (2018 Version), GMSLA 2010 and GMSLA 2000.
- 3.3.2. The specific proposed deliverables and scope for phase one of the ISLA Clause Taxonomy and Library Project will be circulated ahead of the first meeting.
- 3.3.3. The clause library will, for the initial in-scope clauses, be a set library of business variants of a clause, as identified and selected through the CTLWG, based on a number of defined architectural principles, designed to encourage the adoption of the clause libraries and ensuing standards, and successfully deliver the benefits envisaged as set out in paragraph 3.2 above.
- 3.3.4. ISLA has instructed D2 Legal Technology (D2LT), a financial services legal data and LegalTech consulting firm, to support ISLA and its members in delivering phase one of the ISLA Clause Taxonomy and Library Project.
- 3.3.5. Phase one is expected to be completed by 30th November 2020.
- 3.3.6. Further detail of ISLA's legal technology strategy will be detailed in a whitepaper to be published in late 2020 by ISLA setting out a road-map, the approach, methodology, and the critical factors required for the adoption of the intended legal agreement data standards and the longer-term success of the ISLA Clause Taxonomy and Library Project.
- 3.3.7. Following consultation with members, phase one may be extended in order to expand the clause taxonomy to capture additional clauses.
- 3.3.8. Phase two of the ISLA Clause Taxonomy and Library Project will focus on building the clause library for further clauses. We anticipate phase two will commence in early 2021.

## 4. MEMBER PARTICIPATION

- 4.1. It is anticipated that working group calls will be held weekly at a time which will be suitable for US / EMEA participants commencing the week of 7th September 2020 for a duration of one hour. When required, materials will be issued in advance.
- 4.2. Ultimately, the success of the ISLA Clause Taxonomy and Library Project will rely upon input and participation from ISLA members, ensuring alignment with member needs. The CTLWG will ensure such alignment via member consultation. Members of the CTLWG are asked to assist though:
  - Input into the selection and prioritisation of in-scope clauses.
  - Provision of sample clauses (or details of clauses/documentation) for the purposes of establishing the clause taxonomy and library; and
  - Regularly participate in the CTLWG discussions, in order to develop the clause taxonomy and library.

- 4.3. After consideration of this memorandum, all interested ISLA members are invited to contact Tina Baker ([tinajbaker@isla.co.uk](mailto:tinajbaker@isla.co.uk)), David Shone ([david.shone@isla.co.uk](mailto:david.shone@isla.co.uk)) or Akber Datoo ([akber@d2legaltech.com](mailto:akber@d2legaltech.com)) with any comments or questions.
- 4.4. In accordance with all ISLA projects, participation in this working group is conditional upon participants' agreement not to use any part of this process for any anticompetitive purpose. All participating members must agree to engage with the working group in a manner that comports with all applicable antitrust and competition laws and regulations, in line with guidelines that will be provided to the working group participants.
- 4.5. Following circulation of this memorandum, meeting invitations and corresponding materials will be distributed to all participating members.

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<sup>i</sup> The ISDA Clause Taxonomy and Library project was a Financial Times 2019 Award Winner and a Financial Times Innovative Lawyers 2019 Award Winner.