

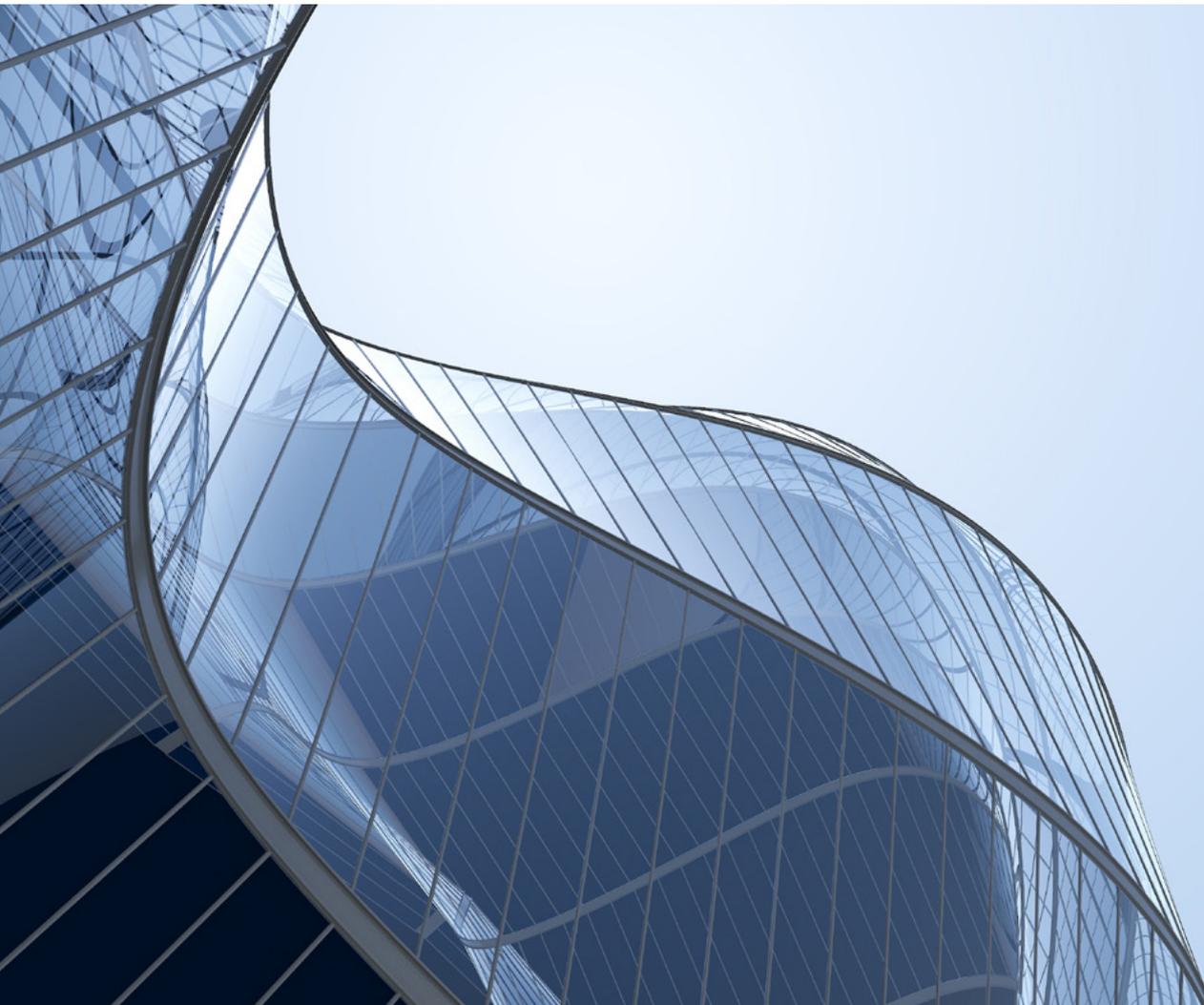
---

ISLA<sup>®</sup>

ashurst

Preparing the Global Master Securities Lending Agreement (GMSLA) for an Evolving Digital Asset Landscape

**November 2022**



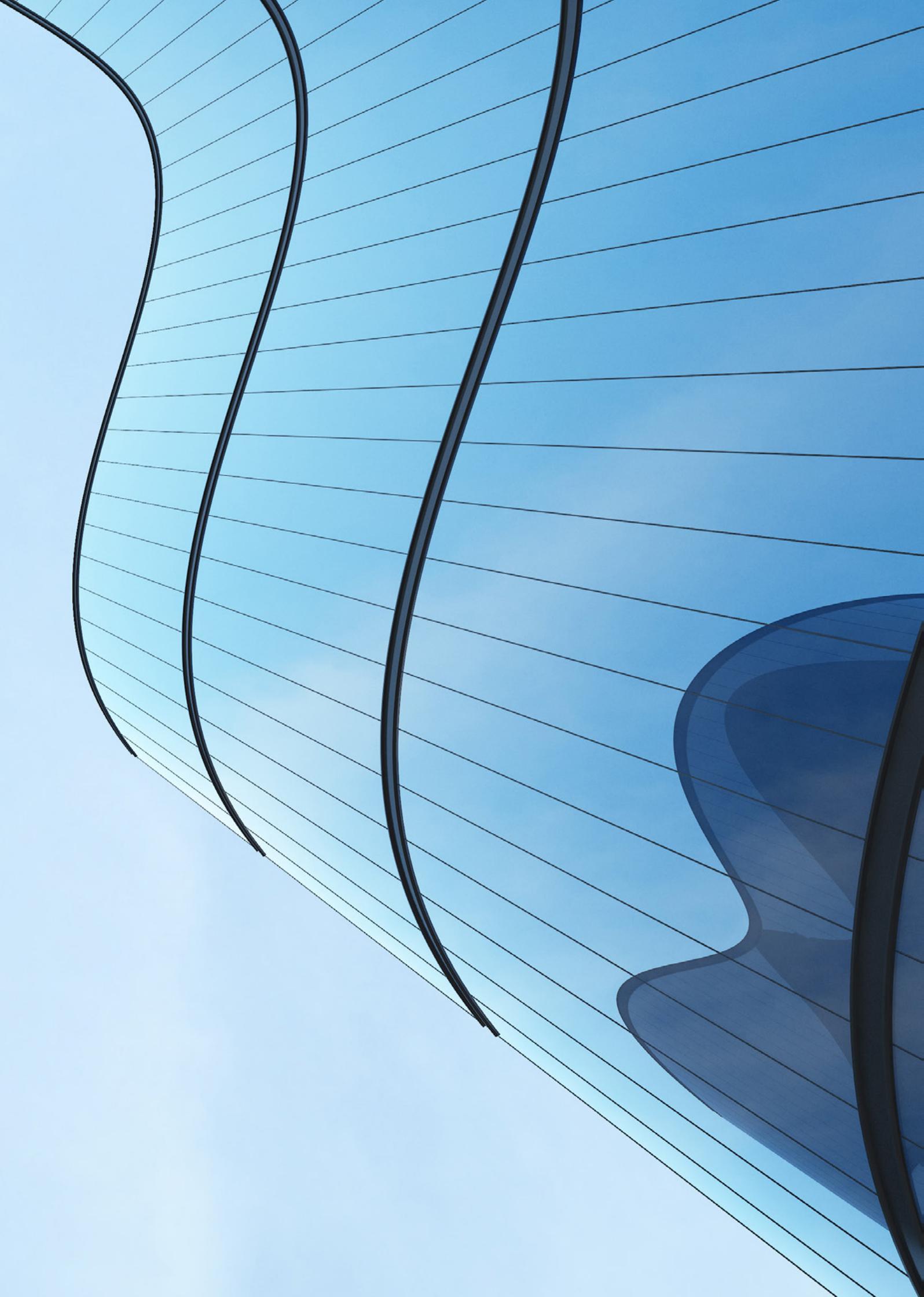


# Contents

1. Executive Summary	4
2. Introduction	6
3. Terminology	8
4. Scope of White Paper	11
5. Key Principles of Securities Lending	12
Key Principle 1: Title Transfer	12
Key Principle 2: Early Termination, Netting & Set-Off	16
Key Principle 3: Security Interest (GMSLA 2018 Only)	18
Key Principle 4: Maintaining the Economics	22
Key Principle 5: Agency & Collateral Management	26
6. Conclusion	27
7. Contributors	27

# 1. Executive Summary

- 1.1** Securities lending is crucial in facilitating market liquidity and flexible financing, playing a vital role in the smooth functioning of financial markets. Meanwhile, digital assets could transform liquidity management and revolutionize today's securities lending market. Given the potential for such developments in the securities lending market, it is important to ensure that the existing framework for securities lending is sufficiently flexible and able to cater for those developments when they arise.
- 1.2** The issues that arise in the context of digital assets broadly break down into the following categories:
- a. Legal – questions relating to the way in which a digital asset is constituted and, consequently, whether it is capable from a legal perspective of being subject to personal property rights; how those personal property rights can be transferred (either on an outright title transfer basis or by way of security); and how a non-defaulting party can exercise its rights in respect of transactions in digital assets upon the default of its counterparty.
  - b. Commercial – questions relating to the extent to which digital assets can be used in securities lending transactions (whether as the loaned asset or as collateral); the allocation of commercial and economic risks arising from transacting in digital assets; and whether and/or how to preserve the economics of a securities lending transaction involving digital assets.
  - c. Documentation – questions relating to whether amendments are required to the existing securities lending documentation to accommodate securities lending transactions involving digital assets.
- 1.3** This paper presents a fundamental first step in analysing these key considerations and the issues that may arise. The purpose of this paper is to identify these considerations and propose a path forward towards the use of the Global Master Securities Lending Agreement (GMSLA) in documenting transactions involving digital assets.
- 1.4** In this paper, we propose:
- a. Working towards producing securities lending documentation which accommodates transactions involving digital assets, either as loaned assets or as collateral.
  - b. Initially focussing on the 2010 GMSLA (Title Transfer) before turning to the 2018 GMSLA Security Interest ('Pledge').
  - c. Where possible, being agnostic as to the type of digital asset that may be involved. To the extent that a potential approach may diverge based on the type of digital asset, we propose focusing first on securities (either debt or equity) which are represented in digital form, including native digital securities, traditional securities which are represented using distributed ledger technology, and tokenised securities, before moving on to other types of digital assets, as appropriate, such as cryptocurrencies, crypto-tokens, stablecoins and non-fungible tokens.
  - d. Engaging ISLA's Regulation & Policy, Digital & FinTech and Legal Working Groups to consider the issues raised in this paper. Those Working Groups would need to comprise a cross-section of ISLA's membership, including those acting in the traditional finance space and digital finance providers, and would be subject to an overarching steering group to ensure consistency and a common direction of travel. In relation to the 2018 GMSLA Security Interest ('Pledge'), we propose that the working group includes the existing custodians who provide custody and account control services in the context of that agreement, as well as custodians in the cryptoasset markets.
  - e. Working towards amendments to the GMSLA by way of Annex or Addendum, acknowledging that some points to be considered may raise complexities when seeking to achieve this when transacting under the same master agreement as traditional securities lending activities.
- 1.5** ISLA will maintain an active role in monitoring and, where appropriate, responding to law reform initiatives in this area. While there may be uncertainty regarding some of the legal issues identified in this paper, ISLA proposes that the documentation be developed to accommodate transactions involving digital assets so that there are documents available to satisfy market appetite to enter into those transactions notwithstanding the potential lack of legal certainty.



## 2. Introduction

- 2.1** Institutional investment in digital assets has gathered pace in recent years, with the world's major financial institutions exploring and/or developing strategies and infrastructure to facilitate digital asset capabilities across the origination and post-trade cycles.
- 2.2** Digital assets have the potential to transform certain aspects of the financial services industry. The securities lending market is likely to need to adapt to reflect those changes, whether that is as a result of securities being constituted or represented in digital format, the use of technology in post-trading settlement systems to facilitate the settlement of securities lending transactions, or the use of non-traditional assets such as cryptocurrencies and cryptotokens either as loaned assets or as collateral.
- 2.3** The GMSLA, as a standardised contract, plays a critical role in facilitating a securities lending market that promotes investor confidence. Therefore, it is imperative that we consider the enhancements that the GMSLA may require to cater for digital assets, striking the balance between safety, efficiency and innovation.
- 2.4** As the leading industry association for securities lending, with:
- a. more than thirty years of experience representing the interests of securities lending market participants, with a reach spanning over 190 members across the globe, comprising buy-side, sell-side, custodians and other service providers; and
  - b. a central role in developing and promoting market best practices and process and legal frameworks, including the GMSLA and related documents,

ISLA is best-placed to effectively lead discussions on (and ultimately implement) the changes that the GMSLA may require to enable market participants to enter into transactions thereunder involving digital assets.

- 2.5** ISLA proposes approaching this undertaking in a sequential way, both in terms of the GMSLA being considered and the type of digital asset.

This means:

- a. Focusing on arrangements under the 2010 title transfer version of the GMSLA (“**GMSLA 2010**”) before considering arrangements under the 2018 Security Interest version of the GMSLA (“**GMSLA 2018**”). This is because the personal property issues associated with security interests over digital assets are significantly more complex than those applicable to title transfer arrangements, and it will be necessary, in the context of the GMSLA 2018 Security Interest documentation, to also consider appropriate control arrangements for digital assets. To avoid these issues holding up the development of documentation and standards applicable to digital assets, it is therefore proposed that we focus first on the title transfer arrangements under the GMSLA 2010.
- b. Focusing on securities (whether debt or equity) which are represented in digital form, including native digital securities, traditional securities which are represented using distributed ledger technology, and tokenised securities, before moving, as appropriate, on to other types of digital asset such as cryptocurrencies, cryptotokens, stablecoins and non-fungible tokens. This is to reflect the nature of ISLA as a trade association for the borrowing and lending of securities, but will primarily be a function of market appetite from ISLA's membership.

ISLA welcomes and looks forward to market participant feedback on these proposals.

2.6 This paper is a starting point in this endeavour. It uses the following key principles of securities lending to chart the issues that could arise where such transaction involves digital assets:

### a. Title Transfer

Issues that need to be considered in relation to the effective transfer by one party to the other of full ownership in the digital asset. These questions will apply in the context of digital assets which constitute the loaned asset and in the context of digital assets being used as collateral under the GMSLA 2010.

### b. Early Termination & Set-Off/Netting

Whether there are any issues that could impede the right of a non-defaulting party to terminate transactions and accelerate obligations under the GMSLA, to determine the value of any delivery obligations and, in the case of the GMSLA 2010, to effectively set off the obligations of the parties under the GMSLA so as to result in a single net sum being payable.

### c. Security Interest

In the context of the GMSLA 2018, questions regarding how to create and perfect a valid security interest over collateral in the form of digital assets, including how the borrower can avoid taking credit risk on the lender or any custodian in relation to the collateral.

### d. Maintaining the Economics

Whether any specific features of a digital asset, or of the digital infrastructure surrounding the digital asset, might affect the economics of a securities lending transaction and, if so, how those economics should be reflected between the parties.

### e. Agency

How an agent lender might hold digital assets on behalf of its clients, and how this affects the Agency Annex and Pooled Principal Addendum.

### f. Collateral Management

How existing collateral management arrangements can be used in respect of digital assets, and whether there are any specific features of a digital asset which might affect how, or by whom, collateral management is effected.

## 3. Terminology

### Digital Asset

- 3.1** The term “**digital assets**” may be used to refer to different types of asset that are represented by or exist in a digital form and which typically utilise distributed ledger technology (DLT) or similar technology.
- 3.2** There is no clear consensus on how to categorise or name the different types of digital asset, and any such categorisation would inevitably be subject to change as the market continues to evolve. There may also be potential overlap between different “categories” of digital asset.
- 3.3** Accordingly, we avoid in this paper referring to different categories of digital asset, other than for the purpose of identifying, in broad terms, the sequential approach to accommodating different types of digital asset. Instead, the focus is on the substantive issues relating to digital assets rather than nomenclature.
- 3.4** It is, however, important to ensure that market participants are not talking at “cross purposes” when considering issues relating to digital assets. As such, we set out below three broad categories of digital assets as a reference point to facilitate subsequent discussions. These categories should only be used against the backdrop described above.
- 3.6** An “**asset-backed digital asset**” exists in a standalone form. Ownership of the digital asset represents a (typically proportionate) ownership interest in the underlying asset.  
Examples include:
- stablecoins;<sup>1</sup>
  - NFTs<sup>1</sup>; and
  - tokens representing interests in or rights relating to an underlying asset, including real estate, personal property and investment funds.
- 3.7** A “**digitised traditional asset**” has all of the features that would be typical of a traditional asset (such as a bond or share), but the holder’s interest in the asset is recorded using a distributed ledger.  
Examples include:
- a registered bond where the register is represented by a distributed ledger;
  - shares in a private company where the register is represented by a distributed ledger; and
  - a post-trade settlement system which uses a distributed ledger to facilitate the settlement of traditional assets, where the nature of the holder’s interest in the asset continues to be an interest in the traditional asset itself rather than in a separate token.

### Types of Digital Assets

- 3.5** A “**native digital asset**” exists in a standalone form; and exists solely in its digital form. It represents a distinct bundle of rights or some other value to which the holder is entitled. Unless it also constitutes an asset-backed digital asset, it does not afford holders a proprietary interest in another asset. It may (but does not have to) represent a bundle of rights against a person.  
Examples include:
- fully-native digital bonds or shares;
  - cryptocurrencies such as ETH and BTC;
  - non-fungible tokens (“**NFTs**”);
  - tokens granting access to or usable solely on a particular platform; and
  - tokens evidencing participation in a decentralised autonomous organisation.
- 3.8** Whether a digital asset is a traditional asset in digital form or representation (that is, a “digitised traditional asset” as described above), or a new and/or natively digital asset may be difficult to immediately ascertain. For example, a registered bond might be constituted using traditional documentation but the issuer may elect to maintain the register on DLT. In this instance, the digital records on the DLT-based register might be considered “digital assets” but only represent the record of ownership and not the bond itself. Consequently, a third party would only be able to discern that the digital assets are mere evidential records of ownership (as opposed to representations of the bond itself) by having access to the underlying constituting documentation.
- 3.9** While there may be some uncertainty as to whether a digitised traditional asset constitutes a “digital asset” for all purposes (since the holder’s interest continues to be an interest in the traditional asset, and the distributed ledger is used for record-keeping purposes only), we include it within the scope of this paper in light of the potential application of these types of asset in the securities lending industry.

<sup>1</sup> To the extent that the stablecoin is backed by the underlying currencies or the NFT is backed by the underlying asset rather than simply being economically pegged to them.



### Economic Terms

- 3.10** By way of background to some of the issues considered in this paper, we set out a brief description of some key terms below.
- 3.11** An “airdrop” refers to the distribution of a digital asset, usually for free, to existing holders.
- 3.12** A “hard fork” refers to a permanent divergence in the DLT ledger, under which the ledger splits into two separate ledgers.
- 3.13** The term “staking” refers to a reward for validation where the holder elects to stake (i.e. lock up) a certain amount of value of the digital asset.



## 4. Scope of White Paper

### Which types of digital asset does this paper cover?

- 4.1 As noted above, there is no clear consensus on how to categorise or name the different types of digital asset, and there may also be overlap between different “categories” of digital asset. This “taxonomy” challenge is likely to persist for a considerable amount of time until global consistency emerges.
- 4.2 This paper is therefore of generic application and does not seek to distinguish between different categories or types of digital asset.
- 4.3 However, in analysing the potential application of the GMSLA to digital assets, while some considerations will be of generic application, others may be relevant to specific types of digital asset. For example, questions regarding how a disruption to the distributed ledger may affect the digital asset and, in turn, how that may be treated under the GMSLA are likely to be relevant to all types of digital asset (although it may be that the consequence differs depending on the type of digital asset). By contrast, questions relating to how to effect a transfer of the digital asset are likely to differ depending on the type of digital asset.

### Which agreements does this paper cover?

- 4.4 This paper covers:
  - a. the GMSLA 2010; and
  - b. the GMSLA 2018
- 4.5 References in this paper to the “GMSLA” indicate that the relevant analysis applies equally to both types of GMSLA.
- 4.6 While we do not specifically address the 2000 version of the GMSLA (and the focus of the documentation initiative will be on the types of GMSLA described above), we note that the general principles described in this paper will likely apply equally to that agreement.

### Which laws does this paper cover?

- 4.7 The answers to the legal questions raised in this paper will depend on the applicable law(s). The applicable law(s) may include English law (as the governing law of each GMSLA), any applicable insolvency law relating to one of the parties to the GMSLA, and any other law with which the digital asset has a close connection. In relation to this latter point, legal systems have typically attributed a hypothetical “location” to intangible assets, and there may be uncertainty as to whether this is the appropriate test, or how to determine this for digital assets.
- 4.8 In conducting a roadmap exercise prior to preparing this paper, ISLA obtained informal guidance on certain issues as a matter of the laws of certain jurisdictions which were considered to be strategically important. Those jurisdictions were: England and Wales, Germany, Switzerland, the United States of America (New York), Japan, Singapore and the United Arab Emirates (Dubai). The purpose of that exercise was to determine the extent to which there was certainty or clarity on some of the issues raised in this paper, and to identify whether there was any consistency in those responses. Ashurst provided the analysis in relation to the laws of England and Wales, Germany, the United States of America (New York and Uniform Commercial Code as proposed by ALI/ULC) and Singapore, while Nishimura & Asahi provided the analysis in relation to Japanese law. We are grateful to these and other counsel for their support in that exercise. By acknowledging and thanking counsel in those jurisdictions, we do not suggest that they have reviewed or endorsed this whitepaper.
- 4.9 The result of that analysis was to confirm that while, in some jurisdictions, there are specific regimes which offer some degree of certainty on some of the issues identified in this paper, none of those jurisdictions provide for certainty in all use cases. Instead, to the extent that there is legal comfort, for example by virtue of a dedicated regime for digital assets, that regime may apply to specific types of digital asset, or may provide comfort in relation to some aspects of this paper but not all.
- 4.10 As we indicate further below, part of the analysis that may be undertaken in due course is to obtain legal advice in relation to some or all of the legal matters considered in this paper. Whether to obtain that advice, and in which jurisdiction to obtain it, will be subject to further consideration by the working group in due course.
- 4.11 As a result, this paper is intended to be jurisdiction-agnostic. That is, to the extent that we identify potential legal questions for consideration, those questions are of generic application and do not relate to a specific legal regime.

## 5. Key Principles of Securities Lending

### Key Principle 1: Title Transfer

#### How does a transferor transfer full legal ownership in the asset to the transferee?

- 5.1** The answer to this question will depend on:
- identifying the relevant law to determine questions relating to proprietary matters;
  - determining, under that law, whether the digital asset is recognised as property; and
  - determining, under that law, how to effect a transfer of that type of property.

#### Conflict of Laws

**5.2** It is therefore important to determine the relevant law(s) to answer this question. There may be multiple relevant laws. When determining issues such as this, courts apply a “conflicts of law” analysis to determine the applicable law. Each jurisdiction has its own conflicts of law principles, although there are cross-border regimes (such as the Rome I Regulation in the European Union) which seek to harmonise the conflicts of law principles across different jurisdictions.

**5.3** It is therefore possible that, for example, if a court in Switzerland were to consider these issues, it would determine that the applicable law is in one jurisdiction, while a court in Singapore would determine that the applicable law is in another jurisdiction. It is therefore not possible to provide an exhaustive and definitive analysis for all fact patterns. While the GMSLA 2010 provides for the exclusive jurisdiction of the English courts, it is possible that other courts might become involved, for example if one of the parties becomes subject to insolvency proceedings.

**5.4** In many jurisdictions, the law that is applicable to questions regarding the proprietary effect of a transfer of property is the law of the jurisdiction in which that asset is located (often referred to as the *lex situs*, or the *lex rei sitae*). While these principles were first developed by reference to tangible property, each jurisdiction has developed principles to attribute a “location” to different types of intangible property.

**5.5** In the context of digital assets, two key questions will therefore remain:

- Which law determines whether to recognise the nature of the digital asset as “property” (such that the *lex situs* analysis applies)?
- What principles would be used to determine where the digital asset is considered to be located, noting in particular the distributed nature of the ledger underpinning the technology?

**5.6** Once the answers to those questions are answered, it may be possible to then consider the question raised earlier about what steps are necessary, under the relevant applicable law, to effect a transfer of the digital asset.

**5.7** For members of UNIDROIT, the UNIDROIT Digital Assets and Private Law Working Group is developing a set of principles which, if implemented, might facilitate an easier resolution of conflicts of laws.<sup>2</sup> For some types of digital assets (for example, digitised traditional assets), it is likely that the existing conflicts of law principles could apply by analogy. This would potentially give rise to unresolved questions relating to identifying the location of the asset which is represented by a distributed ledger, given the distributed nature of the ledger, depending on how the digital asset is structured; for example, if the digitised traditional security is issued in intermediated form, it may be possible to apply traditional principles relating to indirectly-held securities<sup>3</sup> such that a holder’s interest in the securities continues to be represented by, and located in the place of, the account in which that interest is held. The “location” of directly-held digitised securities may be more difficult to ascertain.

**5.8** In the UK, the Law Commission concluded a public consultation on smart legal contracts in 2020,<sup>4</sup> which highlighted the difficulties that arise when applying existing conflicts of law rules to DLT and related technologies—which may include those underpinning digital assets—due to such technologies giving rise to multiple “connecting factors” across different jurisdictions, thereby making it difficult to ascribe a real-world location to a digital asset. Accordingly, the Law Commission is currently undertaking a project which aims to explain how the current rules on private international law may apply to digital assets. As part of the project, the Law Commission will also, if appropriate, recommend legal reforms in the area. It aims to publish the consultation paper in the latter half of 2023.<sup>5</sup>

<sup>2</sup> See <https://www.unidroit.org/work-in-progress/digital-assets-and-private-law/> for more information.

<sup>3</sup> In particular, the “place of the relevant intermediary approach”, or “PRIMA”, as described in the remainder of this sentence.

<sup>4</sup> A copy of the consultation is available at <https://www.lawcom.gov.uk/the-law-of-england-and-wales-can-accommodate-smart-legal-contracts-concludes-law-commission/>

<sup>5</sup> See <https://www.lawcom.gov.uk/project/digital-assets-which-law-which-court/>.



**5.9** Ultimately, legal questions such as these (and the potential uncertainty that exists on these matters) are not within ISLA’s control. ISLA will continue to participate in consultations relating to legal reform, and will obtain analysis from relevant jurisdictions at the appropriate time. We recognise that any developments on these issues may have a significant impact on the way in which transactions are effected. However, we consider that there is market appetite to adopt documentation and to consider the broader issues relating to transactions involving digital assets before such legal certainty exists. We therefore propose continuing with these efforts in the meantime so that standardised, robust documents are available to satisfy market appetite. We welcome feedback on this approach.

**5.10** Until there is further clarity, it may be that a risk-based approach is appropriate when considering some of these issues. For example, if a GMSLA (which is governed by English law) is entered into between a German lender and a French borrower in respect of a digital bond issued by an Irish issuer and held in custody at a Spanish custodian, the parties to that arrangement might take comfort from analysis in some or all of England, Germany, France, Ireland and Spain to determine that the digital asset is recognised as property and, potentially, to reach consensus that the PRIMA approach relating to intermediated securities should apply to determine the location of the bond despite it being a digital asset. The parties could then analyse as a matter of Spanish law which steps are necessary to effect a transfer of the digital bond.

**5.11** Similarly, a risk-based approach might result in the same parties entering into a transaction under which the German lender lends Bitcoin to the French borrower under the same English law GMSLA taking comfort from analysis in some or all of England, Germany and France to determine that Bitcoin is recognised as property and how to effect a transfer of that property, even if there may not be consensus as to which principle (such as PRIMA), and which factors, apply to determine the relevant law governing proprietary matters relating to that asset.

**5.12** A risk-based approach is likely to depend on the particular facts applicable to the relevant digital asset. For example, it is likely to be necessary to identify where the most significant “connecting factors” are to establish or assume a “location” of the digital asset. It may also involve identifying whether there is a specified governing law of the digital asset, as this may be the law that is considered relevant for proprietary matters.

**5.13** Alternatively, some market participants may be comfortable entering into transactions under a GMSLA involving digital assets without investigating these matters, in the expectation that many developed jurisdictions will recognise digital assets as property (even if the nature of that property is unclear) and, as a practical matter, there is a clear understanding amongst market participants as to how ownership in the relevant asset is transferred.

## Key Principle 1: Title Transfer continued...

### Characterisation of Asset

- 5.14** We now turn to the substantive question of whether the digital asset is recognised as property (subject to the foregoing discussion on conflicts of law issues). While it is not possible to be definitive, in practice it is likely that a court in a major jurisdiction with developed legal frameworks would recognise the types of digital assets described in this paper as “property”.
- 5.15** For example, under English law, whilst there is some technical legal uncertainty regarding whether digital assets would fall within the traditionally accepted categories of “property,” the English courts have shown a general willingness to accept some types of digital asset, in particular Bitcoin, as a form of “property”, even if there may be uncertainty as to the type of property represented by the digital asset. The issues of legal uncertainty tend to arise where the digital asset does not give rise to a claim against a third person (such as an issuer), since English law has historically categorised property either as “things in possession” (which some argue a digital asset cannot be) and “things in action” (which may require the availability of a legal right assertable against someone, such as an issuer or other type of debtor). As such, there is greater clarity relating to digital assets such as digitised traditional securities which give rise to legal rights assertable against a third person.
- 5.16** In the U.S., generally speaking, the law governing transfer of ownership is regarded a state law issue, with the degree of technical legal uncertainty varying from state-to-state. In May 2022, the American Law Institute and the Uniform Law Commission<sup>6</sup> approved Uniform Commercial Code (“UCC”) amendments which expressly recognise the ownership and transfer for different types of digital assets. Already adopted by several states as of the date of this white paper, these proposed amendments would recognize most digital assets as “controllable electronic records”, a new asset category for purposes of rules regarding transfers and security interest.
- 5.17** Wyoming, often described as the “Delaware of digital assets”, has become an important jurisdiction for digital assets.<sup>7</sup> Notably, in 2019 it passed Senate File No. SF0125 (“**Wyoming SF0125**”).<sup>8</sup> Wyoming SF0125 amends the previous Wyoming UCC code to define a digital asset as a “representation of economic, proprietary or access rights that is stored in a computer readable format and is either a digital consumer asset, digital security or virtual currency.” It expressly recognises the ownership and transfer of, and provides for security interest in, digital assets.

- 5.18** New York is yet to enact any legislation which expressly categorises digital assets as property (or otherwise). Until New York adopts the proposed amendments to the UCC, the ability to transfer full legal ownership requires analysis under existing law.
- 5.19** Other jurisdictions, notably Germany and the Dubai International Financial Centre, have confirmed the categorization of certain types of digital assets as property (bearer bonds issued as eSecurities and Investment Tokens respectively) under existing laws.

### Characterisation of Asset

- 5.20** In some jurisdictions, such as England and Wales, title transfer arrangements have been recognised without the need for law reform. However, in other jurisdictions there was, prior to law reform, a risk that the courts would construe a title transfer arrangement as a security interest. This then gave rise to the risks that the transfer may be subject to a clawback by the transferor (the lender, in the case of loaned securities; the borrower in the case of collateral under the GMSLA 2010), and that the transferee is not permitted to use the asset. Such an outcome would introduce significant legal uncertainty and be inconsistent with the way in which the market expects the transactions to operate, as it is a fundamental requirement of title transfer arrangements that the transferee is free to deal with the assets.
- 5.21** In the European Union, the Financial Collateral Directive requires EU Member States to implement domestic legislation which recognises and gives effect to “title transfer financial collateral arrangements”. The purpose of the Financial Collateral Directive was, in this regard, to contribute to the integration and cost-efficiency of the financial market and the stability of the financial system in the European Union and to improve the legal certainty of financial collateral arrangements.<sup>9</sup>

<sup>6</sup> Each a sponsoring organisation of the UCC

<sup>7</sup> This is a reference to the fact that Delaware corporate law is the basis for much of American corporate finance. Forbes, What Do Wyoming’s 13 New Blockchain Laws Mean? <https://www.forbes.com/sites/caitlinlong/2019/03/04/what-do-wyomings-new-blockchain-laws-mean/?sh=504742375fde>

<sup>8</sup> Note that Wyoming amended its state laws before the UCC approved its amendments; and accordingly, does not precisely reflect the UCC amendments.

<sup>9</sup> In England and Wales, the relevant domestic legislation has been on-shored following the UK’s departure from the European Union, and so continues to apply.

**5.22** As a first step, it will be necessary to establish whether transactions involving digital assets fall within the scope of any applicable regime. This will involve identifying whether the asset itself falls within the scope of the applicable regime (such as constituting “financial collateral”) and whether the arrangements that can be put in place meet the requirements of that regime (for example, if the regime refers specifically to securities lending transaction, whether the transaction continues to constitute a securities lending transaction for these purposes).<sup>10</sup>

**5.23** Once this has been determined, it will be necessary to consider any potential impact on the documentation. For example, if there are different regimes applicable to different types of asset, is it appropriate to have a single collateral pool, or should eligible and non-eligible assets be separated into separate collateral pools to avoid one tainting the other? Similar questions will arise where each party to the transaction is subject to a separate regime.

#### **Is the description in the GMSLA of how and when the transfer is effected appropriate?**

**5.24** The GMSLA 2010 (and in respect of loaned securities the GMSLA 2018) provides that the lender must deliver loaned securities to the borrower, and the borrower must deliver collateral to the lender. It defines what constitutes “delivery”, requires title to be transferred without encumbrances, and provides additional requirements where title is represented by computer-based book-entry registers.

**5.25** It will be necessary to consider whether these requirements are sufficient in respect of digital assets. For example, market participants may consider that settlement is only considered to be effective once the transfer has been confirmed by a specific number of state changes on the ledger. Depending on the DLT arrangements, including the consensus mechanism, a small number of state changes on the ledger might not be considered sufficient to achieve certainty that the transaction has settled.<sup>11</sup> One approach would be to include this as a requirement in the GMSLA for all transfers of the digital asset, and to allow market participants to specify the relevant number of state changes that they agree represent evidence of an effective transfer. An alternative would be to provide optional wording, allowing parties to switch this requirement on or off on a case-by-case basis (potentially in respect of individual transactions or individual types of digital asset).



#### **Are jurisdiction-specific Annexes required?**

**5.26** ISLA has published a number of different annexes addressing jurisdiction-specific issues arising in the context of securities lending transactions involving those jurisdictions.<sup>12</sup>

**5.27** It may be appropriate to publish additional annexes covering jurisdiction-specific matters relating to the issues considered in this paper. Whether additional annexes are required will depend on market appetite for transactions involving particular jurisdictions, as well as the outcome of any legal analysis involving those jurisdictions.

<sup>10</sup> For a discussion of some of the issues in this context, see the Law Commission's consultation paper on digital assets, a copy of which is available at <https://www.lawcom.gov.uk/project/digital-assets/>.

<sup>11</sup> See paragraph 3.3.2 (Settlement issues) of the Bank of International Settlement's paper on Distributed ledger technology in payment, clearing and settlement (February 2017), which can be found at <https://www.bis.org/cpmi/publ/d157.pdf>, for a brief discussion of this issue.

<sup>12</sup> See Addendums & Country Annexes - ISLA Legal Services ([islaemea.org](http://islaemea.org)).

## Key Principle 2: Early Termination, Netting & Set-Off

**Are there any issues that could impede the right of a non-defaulting party to terminate and accelerate obligations under the GMSLA, to determine the value of any delivery obligations and, in the case of the GMSLA 2010, to effectively set off the obligations of the parties under the GMSLA so as to result in a single net sum being payable on early termination?**

### Background

- 5.28** One of the main benefits of using a master agreement, such as the GMSLA 2010, to enter into securities lending transactions is the ability upon a default to terminate all transactions and convert exposures into a single net sum. Such an arrangement allows market participants to effectively manage their credit risk, by replacing gross credit exposures in respect of individual transactions into a single net exposure.
- 5.29** In addition to being a significant credit risk mitigation tool, the existence of a close-out netting<sup>13</sup> arrangement may allow financial institutions which are subject to prudential regulatory capital requirements to reduce the amount of regulatory capital that they need to hold in respect of their credit exposures. Subject to complying with certain criteria, a close-out netting arrangement enables a relevant financial institution to calculate its regulatory capital requirement by reference to its eligible net credit exposure rather than its gross credit exposures.
- 5.30** To be of most practical benefit (and to satisfy the requirements for a net regulatory capital requirement), a close-out netting arrangement needs to be enforceable upon the insolvency of the defaulting party. ISLA has commissioned opinions in 64 jurisdictions as to the enforceability of the close-out netting arrangements under the GMSLA 2010.<sup>14</sup>
- 5.31** Insolvency laws are typically designed to protect the insolvent entity, and its creditors as a whole, against transactions which deprive the insolvent estate of assets to which the insolvent entity was previously entitled. Some insolvency laws will recognise close-out netting arrangements as not depriving the estate of assets (and therefore permit such arrangements without further consideration). Other insolvency laws may achieve a similar result to contractual close-out netting, automatically setting off obligations owed between the insolvent entity and its counterparty. Other insolvency laws may permit close-out netting arrangements provided they fall within defined criteria (often referred to as “safe-harbour” rules), potentially including the type of master agreement and the type of transaction.

### Close-out netting in the context of digital assets

- 5.32** At a general contractual and commercial level, there is no reason why the close-out netting arrangement in the GMSLA 2010 should not apply equally to transactions involving digital assets. The close-out netting provisions in the GMSLA 2010 are drafted sufficiently broadly that they apply to all transactions between the parties, and all collateral exchanged between the parties, under the GMSLA 2010. Those provisions are not defined by reference to the types of instrument, and there is a single net sum across all transactions and all collateral.
- 5.33** It will be necessary to consider whether the fact that the transactions under the GMSLA 2010 involve a digital asset affect the enforceability of the close-out netting arrangement as a matter of insolvency law. For those insolvency regimes which accept close-out netting without further consideration, it is unlikely that the existence of digital assets would affect the analysis. However, for those insolvency regimes which require a close-out netting arrangement to satisfy certain criteria, it will be necessary to determine whether those criteria continue to be satisfied notwithstanding the existence of digital assets.
- 5.34** This may depend on the type of digital asset – for example, if the asset continues to constitute a bond or share (and transactions in such bond or share are eligible for netting), the fact that it is represented in digital format may not affect the analysis as to whether transactions relating to that asset qualify for close-out netting. It may, however, be more difficult to categorise other types of digital asset within a close-out netting regime which is defined by reference to traditional asset types – for example, there may be uncertainty as to whether a cryptotoken falls within a close-out netting regime which permits netting as between transactions relating to financial instruments.
- 5.35** ISLA therefore expects, in due course, to request counsel to update or supplement their opinions confirming the extent to which the conclusions in those opinions is affected by the use of digital assets within the GMSLA 2010. It will be necessary to consider which jurisdictions, and which types of digital asset, should be prioritised for these purposes.

<sup>13</sup> Reference to “netting” is used in this paper as a commercial concept, rather than representing a statement as to the legal mechanism by which the net result is achieved. In the context of the GMSLA 2010, the close-out provisions utilise set-off to achieve this result.

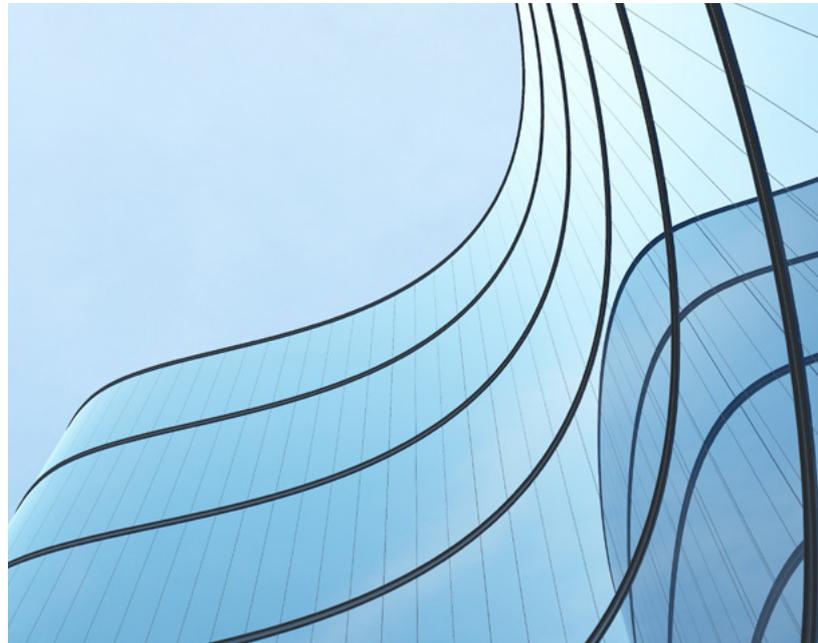
<sup>14</sup> Copies of those opinions are available to ISLA netting subscription holders at <https://www.aoslogin.com/>.

## Documentation and “bad apple” risk

- 5.36** As noted above, the close-out netting provisions in the GMSLA 2010 are drafted generically, and are not limited to individual types of transaction or asset. However, if local insolvency law does not permit close-out netting in respect of digital assets, it may be necessary either to enter into transactions involving digital assets under a separate GMSLA, or to amend the close-out netting provisions so that those transactions are contained within a separate netting pool. This would be to avoid the potential for so-called “bad apple” risk, where the existence of one ineligible trade might be considered to taint the broader portfolio of which it forms part.
- 5.37** Similar issues may arise if there are different regulatory capital requirements applicable to transactions involving digital assets. In this case, depending on the nature of those regulatory capital requirements, it may also be preferable to either document those transactions separately or amend the GMSLA so that there is a separate netting set.

## Payment & Settlement Netting

- 5.38** While distinct from close-out netting, the GMSLA 2010 contains a separate provision for payment and settlement netting. This applies to payments and transfers under the GMSLA 2010 on a day-to-day basis, rather than in the context of a default and close-out. Payment netting involves an account being taken, on each day, of which payments are due in the same currency between the parties under the GMSLA and automatically netting them to produce a single balance which is required to be paid on that day. Settlement netting involves an account being taken, on each day, of which settlement obligations in respect of the same type of fungible assets are due between the parties under the GMSLA and automatically netting them to produce a single delivery obligation which is required to be settled on that day.
- 5.39** Because payment and settlement netting apply on a day-to-day basis rather than upon default or insolvency, questions regarding legal enforceability tend to be more straightforward than is the case in respect of close-out netting. However, in the context of digital assets it may be appropriate to consider broader commercial and practical issues relating to whether and how the settlement netting provisions apply.
- 5.40** For some digital assets, payment or settlement netting are unlikely to be relevant. For example, given their non-fungible nature, it is unlikely that settlement netting would be relevant for NFTs.
- 5.41** For other types of digital asset, payment or settlement netting might be possible, but it may require further investigation as to whether payment or settlement netting is desirable from a commercial and operational perspective. For example, while it may be possible to take an account of different payments due in the same cryptocurrency, the operational set-up for the settlement of those cryptocurrencies may not be consistent with payment netting. One of the main benefits of settlement involving digital assets is the potential for atomic, or near-instantaneous, settlement. The practical benefit of atomic settlement will need to be weighed up against the increased liquidity and pre-funding constraints that would arise if transactions are to be removed from settlement netting. It will also be necessary to consider whether end of day netting would be appropriate, or whether more targeted, intra-day netting arrangements might be in order.
- 5.42** It will therefore be necessary to consider the extent to which payment and settlement netting is expected to be applicable to digital assets, and whether it is necessary to amend the GMSLA 2010 as a result.



## KEY PRINCIPLE 3: SECURITY INTEREST (GMSLA 2018 ONLY)

**In the context of the 2018 Pledge GMSLA, how does the borrower create and perfect a valid security interest over collateral in the form of digital assets?**

**How can the borrower avoid taking credit risk on the lender in relation to the collateral?**

- 5.43** Similar to the position in relation to title transfer, the answer to these questions will depend on:
- identifying the relevant law to determine questions relating to proprietary matters;
  - determining, under that law, whether the digital asset is recognised as property;
  - determining, under that law, how to create and perfect security over that type of property;
  - determining, under that law, whether the collateral forms part of the estate of the lender; and
  - determining, under that law and under insolvency law applicable to the borrower, whether there are any legal restrictions on the lender's ability to enforce the security upon the borrower's default.

**In addition, given that the existing security arrangements used alongside the GMSLA 2018 involve the collateral being held at a third party custodian:**

**Can the digital assets be held by a third party custodian?**

**Does the analysis above apply in relation to the interest of the borrower represented by its relationship with the custodian?**

**Does the borrower take credit risk on the custodian in relation to the collateral?**

- 5.44** The answer to these questions will depend on:
- the issues identified in paragraph 5.43 above, determined after having regard to the location of the custodian; and
  - determining whether, under the law of the location of the custodian, the collateral forms part of the estate of the custodian.

### Conflict of Laws & Characterisation

- 5.45** It is therefore important to determine the relevant law(s) to answer this question. Much of the discussion in paragraph 5.2 above relating to conflicts of law will apply equally to these issues.
- 5.46** However, the following complexities mean that the analysis is more difficult in respect of security than is the case in respect of title transfer.

### Type of Security

- 5.47** There are often different types of security interest applicable to different types of property. For example, some types of security are "possessory" in nature, as they involve the transfer by the security provider of possession of the asset to the collateral receiver. Examples include bailment or pledge. For an asset such as a digital asset, possessory security may not be appropriate in the relevant jurisdiction.
- 5.48** Instead, other types of security interest may exist for intangible assets. Depending on the legal regime, those types of security interest may or may not be appropriate for digital assets.
- 5.49** In some jurisdictions there may be sufficient flexibility with existing types of security interest such that they can apply in respect of a broad range of asset-types. For example, in England and Wales a charge is generally recognised as an effective type of security for a range of types of property, including tangibles and intangibles. However, a similar result may not always arise in all jurisdictions.

### Perfection Requirements

- 5.50** Unlike title transfer arrangements, security interests often involve perfection requirements. These are formalities that need to be satisfied, or steps that need to be taken, to ensure that the security interest is effective as against the collateral provider, its insolvency official and any third party (such as an unrelated creditor of the collateral provider) seeking to assert some proprietary claim over the asset.
- 5.51** Examples of perfection requirements include registering the security at a central registry (such as Companies House in the case of a security provider incorporated in England and Wales), giving notice to a third party such as a custodian, and taking possession of the collateral.
- 5.52** Under the newly proposed Article 12 of the UCC, perfection of security interest in controllable electronic records may be achieved by control or filing of a UCC-1 financing statement.
- 5.53** It will therefore be necessary to consider, in the relevant jurisdictions, whether there are any perfection requirements applicable to the types of security that may be used in respect of digital assets.

<sup>15</sup> As the term "pledge" is used under English law. A "pledge" is used in other jurisdictions, including the United States of America and various civil law jurisdictions, in the context of certain intangibles such as intermediated securities.





## Enforcement of Security

- 5.54** Also unlike title transfer arrangements, the ability of the collateral taker to enforce a security interest is often subject to limitations upon the insolvency of the collateral provider. For example, many jurisdictions impose a stay (or moratorium) on the ability of secured parties to enforce security upon the commencement of insolvency proceedings.
- 5.55** The existence of any such restriction would significantly impact the benefit to the lender of having a security interest over the collateral.
- 5.56** It will therefore be necessary to consider, in the relevant jurisdictions, whether there are any limitations on the ability of a lender to enforce security over digital assets upon the insolvency of the borrower.

## Collateral & Other Exemptions

- 5.57** In a number of jurisdictions, perfection requirements and limitations on enforcement are disapplied in relation to certain types of arrangement. For example, in the European Union the Financial Collateral Directive required EU Member States to implement domestic legislation which disapplies perfection requirements and limitations on the enforcement of security in relation to “financial collateral arrangements”.
- 5.58** The existing security arrangements that have been developed in the context of the GMSLA 2018 have been designed to accommodate the requirements set out in the Financial Collateral Directive. ISLA has commissioned legal opinions in the jurisdictions of the three main custodians who have published account control agreements for use alongside the GMSLA 2018 (England and Wales, Belgium and Luxembourg) as to certain matters arising out of the Financial Collateral Directive in the context of these documents.<sup>16</sup>
- 5.59** As a first step, it will be necessary to establish whether transactions involving digital assets fall within the scope of any applicable exemptions from perfection or limitations on enforcement. This will involve identifying whether the asset itself falls within the scope of the applicable regime (such as constituting “financial collateral”) and whether the arrangements that can be put in place meet the requirements of that regime (such as whether “possession or control” can be achieved).<sup>17</sup>
- 5.60** In developing the existing security arrangements that were developed for the GMSLA 2018, a balance was struck between creating a financial collateral arrangement (such that the lender was able to take comfort relating to the disapplication of perfection requirements and restrictions on enforcement of security in the borrower’s insolvency jurisdiction) and creating an arrangement under which the borrower does not take credit risk on the lender. This was achieved by the use of third party custodians.
- 5.61** From a practical perspective, existing security and account control arrangements are therefore designed for securities which are held with an intermediary. They have been designed for specific jurisdictions and, in relation to the account control arrangements, specific custodians. It may be necessary to establish whether, for any particular type of digital asset, those existing custodians can continue to provide these services, and whether the existing documentation remains appropriate for these purposes.
- 5.62** Alternatively, it will be necessary to consider whether other custodians who are more active in the market relating to the relevant digital assets are available to act in this capacity. If so, it will be necessary to consider establishing similar account control arrangements to those which were put in place in the context of traditional securities under the GMSLA 2018.

<sup>16</sup> Copies of these opinions are available to ISLA members at GMSLA Security Interest Opinions - International Securities Lending Association (ISLA) (<https://www.islaemea.org/gmsla-security-interest/gmsla-security-interest-opinions/>).

<sup>17</sup> See the Law Commission consultation paper referred to above for a discussion of some of the issues in this context.

## Key Principle 4: Maintaining the Economics

### Should the transferor of the digital asset maintain full economic exposure to that asset?

#### If so, how will this economic exposure be maintained in relation to any distinct features of the digital asset?

##### Background

**5.63** Like other financial transactions, securities lending transactions involve an allocation of economic risks associated with the assets to which the transaction relates.

- 5.64** In the context of securities lending transactions under the GMSLA 2010, the allocation of economic risks is as follows:
- a. Because the arrangement constitutes a title transfer arrangement (and to reflect the practical reality of transferring an interest in securities), the borrower's obligation is to return "equivalent" securities and the lender's obligation is to return "equivalent" collateral. For these purposes, "equivalence" is determined by reference to fungibility with the asset to which it relates.
  - b. The lender is required to accept redelivery of the equivalent loaned assets at maturity of the transaction, and so remains economically exposed to fluctuations in the value of the loaned asset. As a result, if during the term of the loan there is a distribution in respect of the loaned assets, the borrower is required to account to the lender for an equivalent distribution.<sup>18</sup>
  - c. The borrower is required to accept redelivery of the equivalent collateral at maturity of the transaction (or as a result of mark-to-market collateral transfers), and so remains economically exposed to fluctuations in the value of the collateral. As a result, if there is a distribution in respect of the collateral before equivalent collateral has been returned, the lender is required to account to the borrower for an equivalent distribution.<sup>19</sup>
  - d. In each case, the method by which the relevant party is required to account (that is, whether it is accounted for by way of manufactured payment or whether it is accounted for at maturity) will depend, in part, on whether the distribution is a cash payment or a distribution of assets.

- e. Under the standard GMSLA 2010, neither party is required to exercise (or procure the exercise of) voting rights in relation to the assets that it has received. Instead, it is free to deal with those assets in the ordinary course of its business.
- f. If a corporate action, such as a conversion, subdivision or pre-emption right, arises in respect of the loaned securities or collateral, the lender (in the case of loaned securities) or borrower (in the case of collateral) may give notice to the other party indicating which resulting asset should form part of the "equivalent" loaned securities or collateral.

**5.65** In the context of securities lending transactions under the GMSLA 2018, and the associated security documents, a similar approach to the GMSLA 2010 is adopted, except that:

- a. Because the lender does not acquire ownership in the collateral, the obligation is to release that collateral, rather than "equivalent" collateral.
- b. Because the lender does not acquire ownership in the collateral, distributions in the collateral are not dealt with by way of manufactured dividend but by way of being credited to the secured account and any excess released using the mark-to-market arrangements.
- c. In relation to collateral, the lender is not permitted to exercise any voting rights, and there are no provisions within the GMSLA 2018 or the security agreement itself requiring the lender to deal with corporate actions in any particular way.

**5.66** It will therefore be important to consider whether there are any unique features applicable to digital assets which would affect the way in which these economics are maintained between the parties.

<sup>18</sup> The lender is not entitled to receive the distribution directly because it is no longer the owner of the loaned asset. The precise withholding tax treatment, and whether the borrower is required to gross up in respect of any taxes, will be agreed bilaterally between the parties in the GMSLA 2010.

<sup>19</sup> The borrower is not entitled to receive the distribution directly because it is no longer the owner of the collateral. The precise withholding tax treatment, and whether the lender is required to gross up in respect of any taxes, will be agreed bilaterally between the parties in the GMSLA 2010.

## Airdrops

- 5.67** An airdrop is the distribution of a digital asset, usually for free, to existing holders of that digital asset.
- 5.68** In many respects, airdrops could be considered to be similar in nature to distributions of income in respect of traditional assets. In both cases, they involve a distribution to a holder of an asset simply as a result of its holding in that asset.
- 5.69** ISLA expects that it will be appropriate to treat airdrops in the same way that income is dealt with in the GMSLA. It will be necessary to consider whether there is market consensus on this point, and whether the provisions relating to cash income or non-cash income would be more appropriate.
- 5.70** In addition, the GMSLA 2010 contains an indemnity if the borrower seeks to substitute non-cash collateral prior to an income record date and, despite alternative collateral being agreed, the substitution is not effected by lender. It will be necessary to consider whether this type of arrangement should apply equally to substitutions of digital asset collateral prior to an airdrop. This is likely to involve consideration of any potential tax treatment, since the indemnity is primarily designed to protect against adverse tax risks associated with a failure to substitute.

## Staking

- 5.71** Staking refers to a reward for validation where the holder elects to stake (i.e. lock up) a certain amount of value of the digital asset.
- 5.72** Similar to airdrops, it may be possible to compare staking to an income distribution in respect of traditional assets, since both involve the distribution of assets to the holder of the original asset. However, unlike airdrops (and unlike an income distribution in respect of traditional assets), staking arises as a result of a choice by the holder as to how to deal with the asset, rather than simply being an inherent right associated with the asset.
- 5.73** The potential application of staking in the context of securities lending transactions will depend on a number of factors. For example, for a digital asset which is the loaned asset under an on-demand loan, it is unlikely that the borrower would stake the digital asset, since doing so ties the asset up for a period of time despite the potential for the lender to recall the loan on demand. The same may apply to digital assets as collateral, since mark-to-market movements may require some of the collateral to be returned at any time.

However, the lender may make a determination based on its expectations as to market movements that, for term loans, a significant portion of the collateral will not need to be returned until maturity of the loan, and may choose to stake that portion. Like cash reinvestment in the traditional securities lending space, it may also depend on whether the staking is at the request of the original transferor.

- 5.74** It will therefore be necessary to consider whether market participants want to require the recipient of a digital asset in respect of a securities lending transaction to be required to account for all, or a portion of, the reward received as a result of staking that digital asset.

## Hard Forks

- 5.75** A hard fork is a permanent divergence in the DLT ledger, under which the ledger splits into two separate ledgers.
- 5.76** In some respects, it may be possible to draw an analogy between a hard fork and certain types of corporate action. For example, a sub-division or stock-split of securities involves one type of security being divided into two or more resulting types of security or other asset.
- 5.77** It will be necessary to consider how to address hard forks in the documentation. In particular, it will be necessary for the documentation to allow the parties to determine which assets are returned (both in relation to loaned securities and, for the GMSLA 2010, collateral). In this regard, ISLA expects that it may be appropriate to deal with this by the existing concept of "equivalence", including the ability of the transferor to give certain directions as to what it expects to have returned (subject to appropriate drafting changes). It will be necessary to consider whether there is market consensus on this and whether greater discretion should be given to one of the parties to determine what the resulting asset should be.

## Events Affecting the Digital Asset

- 5.78** In the context of securities lending transactions involving traditional assets, the GMSLA contains certain provisions dealing with the potential for those assets, or the markets in which they operate, to be disrupted.
- 5.79** The GMSLA addresses these issues through the calculation of the collateral requirement – in particular, through the concept of “Market Value”. The GMSLA provides for an alternative procedure to determine Market Value if the assets are suspended, cannot legally be transferred or are required to be transferred to a government, trustee or third party. It also provides that, rather than just using prices as of close of business, intra-day prices can be used if there has been an exceptional movement in the price of the asset.
- 5.80** As such, the GMSLA does not contain provisions for adjusting or terminating transactions because of an extraneous event (other than a default of the parties), but instead relies on the mark-to-market mechanics to ensure that any credit risks which arise as a result of extraneous events are appropriately mitigated. This is in addition to any recall ability in respect of on-demand loans.
- 5.81** In the context of digital assets, it may be appropriate to consider whether any additional risks arise as a result of the nature of the digital asset or the infrastructure or market in which it operates and, if so, whether those risks are adequately managed by the mark-to-market mechanics or whether new disruption provisions are required.
- 5.82** For example, it will be necessary to consider whether one or both parties should have the ability to either unwind the transaction, replace the asset or otherwise amend the transaction if any of the following occurs:
- a. A network protocol corruption, whether by virtue of cyber-attack or flaw.
  - b. A change in law or regulation, potentially affecting either the ability of either party to perform its obligations or its ability to hedge the transaction, or resulting in an increased cost to either party.
  - c. Infrastructure disruption affecting the distributed ledger.
- 5.83** ISLA expects that, given the specific nature of some types of digital asset, it may be appropriate to include bespoke contractual provisions dealing with these issues, rather than relying on mark-to-market mechanic. The position is likely to differ depending on the nature of the digital asset. It will be necessary to establish whether there is market consensus on this, and if so whether the contractual mechanism would be an early termination right, an adjustment right or another remedy.

## Valuation Methodology

- 5.84** There are two types of valuation under the GMSLA:
- a. “Market Value”, which is used to determine the mark-to-market collateral requirements – this applies in relation to the loaned assets and the collateral, and applies in both the GMSLA 2010 and the GMSLA 2018.
  - b. “Default Market Value”, which is used to determine the value of loaned assets upon a default – this applies to the loaned assets under both the GMSLA 2010 and the GMSLA 2018, and applies to collateral under the GMSLA 2010.
- 5.85** Under the GMSLA 2018, there is no prescribed method for determining the “Default Market Value” of the collateral upon enforcement, as the methods for determining this value will be dependent upon the relevant legal regime. However, associated security agreements may give the lender the ability to “appropriate” the collateral (that is, to take ownership of it and account to the borrower for its value), which may require a valuation methodology to be specified.
- 5.86** Whether these methods for determining value are appropriate for digital assets is likely to depend on the type of digital asset. For example, digitised traditional securities are likely to be valued in the same way as non-digitised traditional securities- the digital nature of those assets is therefore unlikely to require amendments to the way in which these values are defined and determined.
- 5.87** However, it will be necessary to consider whether these valuation methods are appropriate for other types of digital asset. References to “pricing information service” (which is used in the context of “Market Value”) may not be appropriate for all such assets. Similarly, the process for determining Default Market Value is designed specifically for securities and, while it may be possible to apply the same process for other digital assets, it may be appropriate to consider adjustments at a commercial level. For example, it will be necessary to consider whether a valuation window of five dealing days (as applies to securities under the GMSLA) is consistent with the potentially increased volatility of certain types of digital asset.



## Timings

- 5.88** The GMSLA is primarily designed for activities which occur by reference to individual days (or business days).
- 5.89** For example, while there is the potential for “Market Value” to be determined intra-day due to exceptional movements in prices, Market Value is determined each day, such that a single mark-to-market collateral movement occurs each day. The obligation to transfer collateral is therefore expressed to occur on a Business Day.
- 5.90** Similarly, the obligation to transfer loaned securities and the initial or final transfer of collateral is defined by reference to a specified Business Day.
- 5.91** As a result, events of default relating to failure to pay or deliver are likely to be triggered only upon the expiry of the relevant Business Day.
- 5.92** Given the possibility of “atomic” (near-instantaneous) settlement, consideration should be given as to whether the documents should be amended to cater for scheduled settlement at a particular time.
- 5.93** Similarly, the GMSLA provides that notices must be given before close of business to become effective on the same day. Depending on the nature of the relationship between the parties, the possibility of settlement of digital assets beyond traditional “close of business” (potentially 24/7) might result in some market appetite for notices to be capable of being given later in the day. However, we expect that it will be necessary to consider the operational constraints associated with trading and collateral management activities, and the acceptance of formal notices, on a 24/7 basis.



## Key Principle 5: Agency & Collateral Management

**Can an agent lender hold the digital asset on:**

- a. a segregated basis on behalf of its clients; or**
- b. a pooled basis on behalf of its clients?**

**Can a traditional collateral manager hold digital assets as collateral for its clients and move that collateral between the collateral provider's account and the collateral taker's account?**

- 5.94** A detailed discussion of the principles of agency, and of the way in which an agent lender might hold collateral on behalf of its clients, is beyond the scope of this whitepaper.
- 5.95** Similarly, a detailed discussion on the way in which collateral managers function is beyond the scope of this whitepaper.
- 5.96** However, it is important to note that any developments of the GMSLA in the context of digital assets will need to take into consideration the fact that a significant proportion of lending activity is entered into by agent lenders on behalf of their clients. Similarly, a significant proportion of lending activity is collateralised using collateral managers.
- 5.97** As such, any amendments will need to consider the way in which the Agency Annex and Pooled Principal Addendum operate, as well as a consideration of whether those documents continue to apply to digital assets. While ISLA is not responsible for the documents of collateral managers, it may be necessary to consider any broader structural impact if either existing collateral managers cannot facilitate collateral management in respect of digital assets, or if their ability to do so is dependent upon changes to the GMSLA.
- 5.98** This, in turn, is likely to require an analysis of the methods by which agent lenders and collateral managers hold digital assets on behalf of their clients.

---

## 6. Conclusion

This paper presents an important first step in considering the adaptations that the GMSLA may require to facilitate the securities lending market's engagement with digital assets. In doing so, it raises several issues for consideration.

Some of those issues will be a natural part of the considerations undertaken by the working group in developing the documentation.

Other issues, such as potential legal uncertainty, are not within ISLA's control. As noted above, ISLA will continue to participate in consultations relating to legal reform, and will obtain analysis from relevant jurisdictions at the appropriate time. Despite that potential uncertainty, we consider that there is market appetite to adopt documentation and to consider the broader issues relating to transactions involving digital assets.

With engagement from participants representing the full spectrum of the securities lending landscape, comprising buy-side, sell-side, custodians and service providers, ISLA's aim is to ensure that the GMSLA will continue to support the securities finance industry in lending and borrowing activity in an ever-changing digital landscape.

## 7. Contributors



**David Shone**  
Director - Market Infrastructure &  
Technology  
david.shone@islaemea.org



**Tina Baker**  
Head of Legal Services  
tinajbaker@islaemea.org



**Daniel Franks**  
Partner, Global Markets  
daniel.franks@ashurst.com



**Etay Katz**  
Partner, Finance Regulatory,  
etay.katz@ashurst.com



**Tara Waters**  
Partner and Chief Digital Officer and  
Head of Ashurst Advance Digital  
tara.waters@ashurst.com



**Umah Kathirgamathamby**  
Associate, Global Markets  
umah.kathirgamathamby@ashurst.com



The International Securities Lending Association (ISLA) is a leading non-profit industry association, representing the common interests of securities lending and financing market participants across Europe, Middle East and Africa. Its geographically diverse membership of over 190 firms includes institutional investors, asset managers, custodial banks, prime brokers and service providers.

Working closely with the industry, as well as national, regional, and global regulators and policy makers, ISLA advocates for, amongst other things, the importance of securities lending to the broader financial services industry. It supports both the Global Master Securities Lending Agreement (GMSLA) legal framework, including the Title Transfer and Securities Interest over Collateral variants, as well as the periodical enforceability and security enforcement across global jurisdictions.

Through member working groups, industry guidance, consultations and first-class events, ISLA plays a pivotal role in the creation and promotion of market best practices and processes, thought leadership, standards for legal frameworks, and securities lending guides and related documents.

Found here: [www.islaemea.org/about-isla](http://www.islaemea.org/about-isla)



Ashurst is a leading global law firm with world class capability and a prestigious global client base. The firm's in-depth understanding of its clients and commitment to providing exceptional standards of service has seen it become a trusted adviser to local and global corporates, financial institutions and governments on all areas of commercial law. The firm's people are its greatest asset and it brings together lawyers of the highest calibre with the technical knowledge, industry experience and regional know-how to provide the incisive advice clients need.

Ashurst has 30 offices in 17 countries and offers the reach and insight of a global network, combined with the knowledge and understanding of local markets. With over 450 partners and a further 1,800 lawyers working across 11 different time zones, the firm is able to respond to clients wherever and whenever required. As a global team, Ashurst has a reputation for successfully managing large and complex multi-jurisdictional transactions, disputes and projects and delivering outstanding outcomes for clients.

## General Enquiries

Email: [support@islaemea.org](mailto:support@islaemea.org) | [www.islaemea.org](http://www.islaemea.org)

## Disclaimer

While we have made every attempt to ensure that the information contained in this paper has been obtained from reliable sources, the International Securities Lending Association (ISLA) is not responsible for any errors or omissions, or for the results obtained from the use of this information. All information in this Report is provided "as is", with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, express or implied, including, but not limited to warranties of performance, merchantability and fitness for a particular purpose. Nothing herein shall to any extent substitute for the independent investigations and the sound technical and business judgment of the reader. In no event will ISLA, or its Board Members, employees or agents, be liable to you or anyone else for any decision made or action taken in reliance on the information in this Report or for any consequential, special or similar damages, even if advised of the possibility of such damages. The information provided is not intended to be a comprehensive review of all developments in the law and practice, or to cover all aspects of those referred to. Readers should take legal advice before applying it to specific issues or transactions.