THE REVIEW OF
BANKING & FINANCIAL SERVICES
A PERIODIC REVIEW OF SPECIAL LEGAL DEVELOPMENTS AFFECTING LENDING AND OTHER FINANCIAL INSTITUTIONS

Vol. 35 No. 5 May 2019

THE IMPACT OF TECHNOLOGICAL INNOVATIONS ON DERIVATIVES DOCUMENTATION: A BUY-SIDE PERSPECTIVE

Smart derivative contracts and blockchain are two new technologies that are designed to improve efficiency and streamline processes supporting derivatives transactions, including documentation processes. The authors discuss these technologies from a buy-side perspective, focusing on a variety of issues, including automatable smart contract terms and data harmonization. They then turn to the impact of the new technologies on buy-side entities, discussing customizability, dispute resolution, and the importance of ascending the learning curve.

By Blake Estes and Willa Cohen Bruckner *

Advances in technology have resulted in greater efficiencies and lower costs across a wide spectrum of industries, and the derivatives industry is exploring how it, too, can benefit from technological innovation. Following the 2007-2009 financial crisis and the resulting reforms in the G20 countries, the complexity of the operation of the derivatives markets has increased significantly.[1] As a result of post-financial crisis reform mandates, market participants have had to layer mechanisms and practices for addressing reporting, clearing, execution, and margin responsibilities (among others) into legacy infrastructure. Each of these additional responsibilities creates compliance and risk management challenges, and introduces inefficiencies and costs into derivatives documentation and processing. The derivatives industry is looking to a variety of technology solutions to address certain of these frictions in its markets.

The benefits of technology solutions are most obvious for large sell-side financial institutions that engage in a high volume of derivatives transactions and documentation with myriad customers. For buy-side entities,[2] however, the benefits of such new technologies are less clear, as each buy-side entity must balance the advantages of increased efficiency and reduced costs against the disadvantages of a diminished ability, in some cases, to customize trading arrangements. As momentum builds for the next wave of derivatives innovation through technology, buy-side entities can

[1] G20 Leaders Statement: The Pittsburgh Summit (September 24-25, 2009), Pittsburgh, Pennsylvania, http://www.g20.utoronto.ca/2009/2009communique0925.html. In an effort to address systemic risks to the global financial system posed by financial derivatives following the financial crisis, leaders of the world's G20 countries met in Pittsburgh, Pennsylvania to devise a more robust framework of regulations for OTC derivatives.

[2] In using the term "buy-side entities", we refer to entities other than large financial institutions (*e.g.*, corporates, hedge funds and other funds, and small financial institutions).

* *BLAKE ESTES is a counsel in the Financial Services and Products Group at Alston & Bird LLP. WILLA COHEN BRUCKNER is a partner in the Group. Their e-mail addresses are blake.estes@alston.com and willa.bruckner@alston.com.*

INSIDE THIS ISSUE