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Financial Market Infrastructure Act

FMIA Rules for OTC Derivatives: What You Need to Know

General

The Swiss Financial Market Infrastructure Act (FMIA) came into force on January 1, 2016. FMIA primarily focusses on rules for trading venues such as stock exchanges (on EU-Level contained in the Markets in Financial Instruments Regulation (MiFIR)) but also includes various obligations for market participants, both from the financial sector and other sectors. Among these obligations are the notification duties for important shareholders taken over from the former Stock Exchange Act as well as new rules for derivative transactions inspired by the European Market Infrastructure Regulation (EMIR).

Personal Scope: Who is in scope of FMIA?

The new FMIA rules are not only addressed at the typical financial market participant such as banks, security dealers or investment funds but extend to any enterprise engaging in derivative transactions for investment or hedging purposes. The law considers as an enterprise any commercial venture, regardless of its legal form, from one-man businesses to large international corporations.

Status: Are all counterparties treated the same way?

The FMIA obligations do not uniformly apply to all types of enterprises but are tailored to their relevance as a counterparty in a derivative transaction, i.e. to its possible impact on market stability and the functioning of the market. Financial Counterparties (FC) must fulfil the most obligations while the rules for Non-Financial Counterparties (NFC) are less stringent. Both categories are in their turn subdivided into large and small counterparties, depending on their trailing 30-working days average of gross exposure of their open derivatives transactions. Derivative transactions for hedging purposes directly related to the counterparty's business purpose or liquidity or asset management are not taken into account. Therefore, FMIA knows four different categories in total (FC+, FC-, NFC+, NFC-).

The status of a counterparty is important for determining the concrete obligations it has to fulfil under FMIA rules. Each counterparty may generally rely on the information provided to it by the other side regarding its status. For this purpose, SwissBanking has created the so-called FMIA Appendix as part of its standard derivative documentation.

Material Scope: What transactions are in scope of FMIA?

The market behavioural rules of Art. 93 ss. FMIA generally apply to derivative transactions. Swiss law defines a derivative transaction as a financial contract the value of which depends on the value of one or more underlying financial assets.

Some obligations only apply to OTC derivatives while certain transactions are completely exempt from the FMIA rules.

Transactions: What are OTC derivative transactions?

OTC derivatives are derivatives not traded on a trading venue. Trading venues under Swiss law are stock exchanges or multilateral trading facilities. The Swiss definition is slightly narrower than the definition under EMIR, where an OTC derivative is any derivative not traded on a regulated market (the equivalent to a stock exchange under FMIA).

Exemptions: Which transactions are exempt from the FMIA market behavioural rules?

Not in scope of the rules are structured products, securities lending and borrowing and commodity derivatives which only permit physical delivery.

Obligations: What are the obligations under FMIA?

The market behavioural rules for derivative transactions fall into four main groups: the obligations to use central clearing, to report transactions to a trade repository, to employ risk mitigation measures and, finally, to trade certain derivatives via a trading venue or an organized trading facility (platform trading).

These obligations are coming into force at different points in time, in timely coordination with the relevant EMIR provisions. Currently, the only obligations in force are the obligation for all types of counterparties to employ risk mitigation techniques and some margin requirements for the largest types of counterparties.

Reporting obligation: The next obligation coming into force

The reporting obligation comes into force over the next 6 to 12 months, counting from April 1, 2017:

· For FC+ and central counterparties:	from October 1, 2017
· For FC- and NFC+	from January 1, 2018
· For all other situations	from April 1, 2018

Trade Repositories: Which trade repositories are available in Switzerland?

On April 1, 2017, the Swiss Financial Market Supervisory Authority (FINMA) approved SIX Trade Repository Ltd as the first Swiss trade repository.

At the same time, FINMA recognized the Luxembourg domiciled REGIS-TR SA as a recognized foreign trade repository (for more information see www.regis-tr.com). Counterparties may select either provider to fulfil their reporting duties under FMIA.

Reporting cascade: Which counterparty must report?

Unlike EMIR, FMIA applies the reporting obligation only unilaterally. The party obligated to report the transaction to the trade repository is determined using the following cascade:

· FC and NFC:	FC
· (N)FC+ and (N)FC-:	(N)FC+
· (N)FC+/- and (N)FC+/-:	Seller
· NFC- and NFC-:	no reporting obligation

The Swiss domiciled counterparty must report in any case if the foreign domiciled counterparty does not report under the applicable foreign law. If the transaction is centrally cleared, the reporting obligation lies with the central counterparty. However, if a (foreign) central counterparty does not report, the reporting obligation remains with the counterparties directly.

Reporting content: What needs to be reported and when?

The conclusion, amendment or termination of the transaction must be reported T+1. The report contains at least: identity of the counterparties, type of transaction, due date, nominal value, price, value date, currency.

The exact format and other technical modalities may be checked with the trade repositories offering the service.

Risk mitigation techniques:

The risk mitigation techniques are meant to reduce either the operational risk or counterparty risk. Operational risk mitigation techniques are:

- Timely confirmation of contractual terms
- Having dispute resolution procedures in place

- Engaging in portfolio reconciliation
- Considering portfolio compression
- Daily valuation of open positions

Exchanging collateral serves the purpose of reducing counterparty risk.

These obligations do not apply to derivative transactions which are – on a mandatory or voluntary basis – centrally cleared or to FX swaps and forwards. Also, these obligations depend on certain combinations of counterparties only.

Collateral: Who needs to exchange collateral?

The obligation to exchange collateral is introduced in a phased approach. Currently, only the largest counterparties need to exchange initial collateral. Except for NFC-, all counterparties must exchange variation margin from September 1, 2017.

Collateral: What may be used as collateral?

The margin rules provide for a broad range of eligible collateral for both the initial margin and variation margin requirements:

- Cash, bank issued money market instruments
- High-grade debt issued by governments or agencies
- High-grade debt issued by corporates
- High-grade covered bonds
- Certain blue chips shares
- Gold
- Money market funds

Collateral must be valued on a daily basis. Variation margin must be exchanged from 1 September 2017 for most situations.

Documentation and Resolution

All counterparties have to regulate in writing the processes with which they ensure fulfilment of their derivatives obligations under FMIA. This also applies to FC that have been appointed by other counterparties to implement their obligations under FMIA.

Further, NFC that do not want to trade in derivatives have to set forth such resolution in writing.

Overview on FMIA obligations (depending on counterparty status):

Duty Status	FC+	NFC+	FC-	NFC-
Trade reporting	⊗	⊗	⊗	⊗*
Risk mitigation				
Confirmation	⊗	⊗	⊗	⊗
Portfolio reconciliation	⊗	⊗	⊗	
Dispute resolution	⊗	⊗	⊗	⊗
Portfolio compression	⊗	⊗	⊗	⊗
Valuation	⊗	⊗		
Collateral				
Initial margin	⊗			
Variation margin	⊗	⊗	⊗	

* Unless other counterparty is also NFC- (see above)

Outlook: Further technical specifications under review

The detailed technical provisions of the FMIA rules on OTC derivative transactions can be found in the Federal Ordinance on Financial Markets Infrastructure (FMIO). The current margin rules shall now be adapted to the latest EMIR rules introduced in February 2017, in order to ensure a level playing field for Swiss market participants. Consultation on this project has already closed. The entry into force of the revised FMIO is planned for August 2017.

In particular, the revision plans to broaden the exemptions for exchanging collateral and the range of eligible collateral. Furthermore, it is planned to amend the hair-cut rules. Like in the EU, it shall no longer be necessary to apply an additional hair-cut of 8% for variation margin posted in a different currency than applicable to the underlying transaction.

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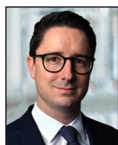

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