LENZ & STAEHELIN

The world's Swiss law firm

Update

Newsflash March 2017

FinfraG Update III – Swiss Federal Department of Finance launches consultation on the amendment of the Financial Market Infrastructure Ordinance

The purpose of this Newsflash is to provide Swiss market participants with an update on the proposed amendment of the Swiss Financial Market Infrastructure Ordinance (draft FMIO) regarding the implementation of the obligation to exchange collateral under the Swiss Financial Market Infrastructure Act (FMIA). The consultation process was launched by the Swiss Federal Department of Finance (FDF) on February 13, 2017 and will last until April 13, 2017. The new provisions are expected to enter into effect on August 15, 2017.

Background

The FMIA and its implementing Ordinance (FMIO) which entered into effect on January 1, 2016 impose on Swiss counterparties a number of obligations, *inter alia* the obligation to exchange collateral (variation margin and initial margin) for OTC derivatives not cleared by a central counterparty.

The provisions of the FMIO regarding the implementation of the obligation to exchange collateral follow the existing EU regulations and international standards in order to prevent Swiss financial market participants from being disadvantaged in relation to their European competitors.

Since 2016, the EU regulations have faced several amendments. With respect to the obligation to exchange collateral, the recent EU Regulation 2016/2251, which entered into effect on January 4, 2017, lays out the final implementation requirements for the timely, accurate and appropriately segregated exchange of collateral.

Following the publication of the EU Regulation 2016/2251, the Swiss Financial Market Supervisory Authority (FINMA) published on January 31, 2017 the Guidance 01/2017 which provides information about the schedule for the implementation of the Swiss regulations on the exchange of collateral.

On February 13, 2017, the FDF launched a consultation on the amendment of the FMIO with the aim of aligning the Swiss requirements with the corresponding EU provisions. The consultation period will last until April 13, 2017. The new provisions are expected to enter into effect on August 15, 2017 at the latest.

Overview of the proposed Amendments

The draft FMIO provides for the following amendments:

a) Obligation to exchange collateral (Art. 100 draft FMIO)

As regards the obligation to exchange initial margins, the existing FMIO provides that the calculation of the group aggregated month-end average gross position of OTC derivatives shall include all non-centrally cleared OTC derivatives of the group including all intragroup non-centrally cleared OTC derivatives. The draft FMIO explicitly clarifies that such calculation shall take intra-group OTC derivatives transactions only once into account (para. 2). In addition, the obligation to provide initial margins applies from January 1 of the year in question to December 31 of the following year (para. 3).

b) Exemptions from the obligation to exchange collateral (Art. 100a draft FMIO)

The obligation to exchange initial margins may be waived if this would be provided for the currency components of "currency swaps" (para. 2). In addition, if one of the counterparties is a guaranteed bond issuer or the legal entity of a guaranteed bond fund, this counterparty may, subject to the conditions set out under Art. 86 para. 3 draft FMIO, agree with the other counterparty that the exchange of initial margins may be waived (para. 3 let. a) or that the exchange of variation margins may be waived *vis-à-vis* the counterparty who is a guaranteed bond issuer or the legal entity of a guaranteed bond fund and the other counterparty may provide variation margins in cash (para. 3 let. b).

c) Reduction of initial margins (Art. 100b draft FMIO)

The counterparties may reduce their initial margins by an amount up to CHF 50 Mio (para. 1). In the case of counterparties which are part of a financial or insurance group or of a group of companies, the amount of initial margins is determined including all group companies (para. 2). In the case of intra-group transactions the initial margins may be reduced by an amount up to CHF 10 Mio. (para. 3).

d) Timing of the calculation and posting of initial margin (Art. 101 draft FMIO)

As regards timing, the draft FMIO explicitly addresses calculation and posting of initial margin.

The initial margins must be calculated for the first time within one business day of the execution of the derivatives transaction in question and must thereafter be calculated regularly, but at least every ten days (para. 1). Where both counterparties are located in the same time-zone, the calculation shall be based on the netting set of the previous business day. By contrast, where both counterparties are not located in the same time-zone, the calculation shall be based on the transactions in the netting set which are entered into before 16.00 of the previous business day in the time zone where it is first 16.00 (para. 2). It is further specified that the initial margins must be posted on the day of the calculation under para. 1; as regards settlement, the trade-standard deadlines shall apply (para. 3).

e) Timing of the calculation and posting of variation margin (Art. 101a draft FMIO)

Similar to initial margin, the draft FMIO explicitly addresses the timing of the calculation and posting of variation margin.

The variation margins must be re-calculated at least on each business day (para. 1). It is further specified that the variation margins must be posted on the day of the calculation under para. 1. It is noteworthy, though, that the draft FMIO then also distinguishes between posting and settlement; as regards settlement, the trade-standard deadlines shall apply (para. 3). By way of derogation from para. 3, it is possible to post variation margin within two business days from the valuation date provided that (i) a counterparty that is not obliged to post initial margin has provided prior to the calculation date additional collateral which fulfills certain conditions, or (ii) the counterparties have posted initial margins subject to a specific margin period of risk (para. 4).

f) Treatment of initial margin (Art. 102 draft FMIO)

The treatment of initial margin is specified. Now, the initial margin provided in cash must be kept with a central bank or with a Swiss or foreign bank. In addition, it is specified that initial margins provided other than in cash may be held by third parties (para. 3) and that the use of initial margins for other purposes is not allowed except under very limited circumstances as described in para. 4.

g) Admissible collateral (Art. 104 draft FMIO)

As under EU Regulation 2016/2251, securities funds within the meaning of Art. 53 of the Swiss Collective Investment Schemes Act are now considered admissible collateral provided that (i) the funds' units are valued on a daily basis and (ii) the collective investment schemes invest exclusively in assets described under Art. 104 para. 1 let. a to g FMIO or in derivatives hedging assets described under Art. 104 para. 1 let. a to g FMIO (Art. 104 para. 1 let. H draft FMIO).

h) Swiss FX Haircut rules (Art. 105 draft FMIO)

One of the most anticipated changes is the alignment of the Swiss FX Haircut rules with the EMIR FX Haircut rules. The FDF proposes that the FX Haircut of 8% shall in the case of initial margin apply to all cash and non-cash initial margin provided in a currency other than the agreed termination currency (para. 2 let. a) and in the case of variation margin to non-cash variation margin only if it is provided in a currency other than the currency agreed in an individual derivative contract, the relevant master netting agreement or the relevant credit support annex (para. 2 let. b).

i) Cross-border transactions (Art. 106 draft FMIO)

The possibility for a Swiss counterparty to waive the exchange of initial and variable margins in case of cross-border transactions is extended to other structures. In particular, a Swiss counterparty may waive the exchange of collateral when (i) the foreign counterparty has its registered seat or is domiciled in a jurisdiction where the set-off or collateral agreement cannot be legally enforced, or (ii) where the segregation agreement does not correspond to internationally recognized standards (para. 2^{bis} and 2^{ter}).

j) New transitional deadline (Art. 131 draft FMIO)

In addition to the new transitional deadlines provided for in the FINMA Guidance 01/2017, the draft FMIO provides for a new transitional deadline: The obligation to exchange collateral applies only as of January 4, 2020 for non-centrally cleared OTC derivatives which are single-stock equity options or index options.

For any further questions regarding this matter please do not hesitate to contact us.

Your contacts

Geneva / Lausanne

François Rayroux
francois.rayroux@lenzstaehelin.com
Tel: +41 58 450 70 00

Zurich

Patrick Hünerwadel
patrick.hunerwadel@lenzstaehelin.com
Tel: +41 58 450 80 00

Our offices

Geneva
Lenz & Staehelin
Route de Chêne 30
CH-1211 Genève 6
Tel: +41 58 450 70 00
Fax +41 58 450 70 01

Zurich
Lenz & Staehelin
Bleicherweg 58
CH-8027 Zürich
Tel: +41 58 450 80 00
Fax +41 58 450 80 01

Lausanne
Lenz & Staehelin
Avenue du Tribunal-Fédéral 34
CH-1005 Lausanne
Tel: +41 58 450 70 00
Fax +41 58 450 70 01

www.lenzstaehelin.com