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Derivative Trading under the Federal Act on Financial Markets Infrastructure

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I. Introduction

1. From Pittsburgh to Bern via Basel, Brussels and Washington

On 1 January 2016, the Federal Act on Financial Markets Infrastructure of 19 June 2015[1] will enter into force.[2] This will be a major milestone on the road from the financial crisis of 2007–2008 to a new architecture for the regulation of Swiss financial markets.[3] Indeed, to understand the FMIA, it is necessary to look back at the bankruptcy of Lehman Brothers and its aftermath: in the wake of the financial crisis of 2007–2008, regulators came to realize that the over-the-counter (OTC) derivatives markets had grown to immense proportions out of their sight. The leaders of the G-20 Member States met in Pittsburgh. Among their high hopes for a new global regulation of financial markets, they agreed that, in order to prevent future crises measures should be taken to improve the OTC derivatives markets. More specifically, they agreed that:

> *«all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives mar-*

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1 Federal Act on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading of 19 June 2015, BBl. 2015 4931.

2 Federal Department of Finance, «Federal Council brings Financial Market Infrastructure Act into force as at 1 January 2016», Press release of 25 November 2015, https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news_list.msg-id-59647.html.

3 See, e.g., Daniel Roth, Gesetzgebungsprojekt: FIDLEG, FINIG und FinfraG, SZW 2014, 608, p. 608.

kets, mitigate systemic risk, and protect against market abuse.»[4]

The leaders' statement implies four objectives:

- a requirement to trade certain standardized OTC derivatives on a stock exchange or an electronic platform to ensure post- and, possibly, even pre-trade transparency for the whole market and ensure a more open price-setting process;
- a requirement to clear certain standardized OTC derivatives through a central counterparty (CCP) to reduce operational and counterparty risk by relying on the centeralized risk management system offered by a clearing house;
- to report trades to a trade repository to ensure that regulators have a granular yet global view of the market; and
- to impose higher capital requirements for non-centrally cleared derivatives.

Following this statement, the Toronto G-20 Summit added to these objectives a fifth pillar: the requirement to mitigate the risks of non-centrally cleared OTC derivatives to ensure that, even if the main objectives are not achieved, measures will be in place to avoid such risks.[5]

Following the G-20 Leaders' statement in Cannes in November 2011, the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS), the International Organization for Securities Commissions (IOSCO) and other international standard setters were called into action[6] and have kept busy since then.[7]

At the national level, the United States passed into law the Dodd-Frank Act of 2009,[8] the in the United States and the European Union adopted EMIR[9] and CSDR,[10] as well as MiFID II[11]/MiFIR.[12] Both sets of regulations provide for extensive rules relating to counterparties from foreign/non-member states.[13] Therefore, Switzerland needed to follow suit if not out of sense of belonging to the international community, at least in order to maintain its access to foreign markets.[14]

The FMIA emerged against this backdrop. It is as a key legislation for Switzerland's international financial policy. Its main objective will be, for Switzerland, to be recognized as having an equivalent regulation under article 13 (2) EMIR. For this reason, after an initial period of inactivity,[15] the government made it a priority to adopt rules on derivatives trading. Once the regulatory machine got started, the FMIA was marshalled through the legislative process with a consultation process initiated in December 2013,[16] a bill presented to parliament in September 2014[17] and the final act passed into law on 19 June 2015.[18] The government maintained the pace to adopt the implementing regulations: a consultation period was open from 20 August 2015 until 2 October 2015.[19] The final version of the Ordinance on Financial Markets Infrastructure (FMIO) was published on 25 November 2015.[20]

2. An Overview of the FMIA

The FMIA has a broader scope than derivatives trading. It is part of the reform of the regulatory architecture moving away from the current pillar system to a new system based on sector-specific regulations that applies to the entire financial sector, with the Federal Act on the Financial Markets Supervisory Authority of 22 June 2007 (FINMASA)[21] governing the supervision of financial markets and institutions, the FMIA creating a regulatory frame-

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4 Leaders' Statement, The Pittsburgh Summit, September 24–25, 2009, N 13, p. 9, https://www.treasury.gov/resource-center/international/g7-g20/Pages/g20.aspx.

5 Leaders Statement, G-20 Toronto Summit Declaration, 26–27 June 2010, N 25, available at https://www.treasury.gov/resource-center/international/g7-g20/Pages/g20.aspx.

6 Leaders Statement, G-20 Cannes Summit Final Declaration, N 24, p. 5 available at https://g20.org/wp-content/uploads/2014/12/Declaration_eng_Cannes.pdf.

7 For an overview of the current status, see Financial Stability Board, OTC Derivatives Market Reforms: Tenth Progress Report on Implementation, 4 November 2015, available at www.financialstabilityboard.org. See also Hans Kuhn, Die Regulierung des Derivathandels im künftigen Finanzmarktinfrastrukturgesetz, GesKR 2014, 161, p. 162.

8 Dodd-Frank Act Wall Street Reform and Consumer Protection Act, Public Law 111-203, H.R. 4173.

9 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, Official Journal of the European Union, L 201/1 of 27 July 2012.

10 Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012, Official Journal of the European Union, L 257/1 of 28 August 2014.

11 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, Official Journal of the European Union, L 173/349 of 12 June 2014.

12 Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 Official Journal of the European Union, L173/84 of 12 June 2014.

13 See, e.g., art. 13 (2) EMIR on the equivalence procedure for the rules on derivatives.

14 See Kuhn (n. 7), p. 161.

15 See ibid, p.165.

16 Federal Department of Finance, «Federal Council launches consultation on Financial Market Infrastructure Act», Press release of 13 December 2013, https://www.news.admin.ch/message/index.html?lang=en&msg-id=51372.

17 See Botschaft zum Finanzmarktinfrastrukturgesetz (FinfraG) vom 3. September 2014, BBl 2014 7483 (Botschaft FinfraG).

18 BBl. 2015 4931.

19 Federal Department of Finance, «Hearing on Financial Market Infrastructure Ordinance», Press release of 20 August 2015, available at https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-58394.html.

20 Federal Department of Finance, «Federal Council brings Financial Market Infrastructure Act into force as at 1 January 2016», Press release of 25 November 2015, https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news_list.msg-id-59647.html.

21 SR 956.1.

work to ensure that markets operate properly by regulating the conduct of market participants, the future FinSA regulating financial services and products, and the future FinIA on financial institutions.[22]

In this context, the FMIA aims to ensure functioning and transparent securities and derivatives markets as well as the stability of the financial system.[23] It also seeks to protect investors and ensure that they are treated equally.[24] To achieve these goals, the FMIA creates a systematic regulatory framework for the prudential supervision of market infrastructures,[25] a broad concept encompassing stock exchanges, multilateral trading venues and organized trading venues, central depositories, central counterparties, payment systems and trade repositories.[26] The FMIA was also the opportunity to revise the insolvency regime to protect the porting of derivative trades from insolvency and to ensure a better protection of the private enforcement and netting.[27] In parallel, it extended the scope of FINMA's insolvency jurisdiction to non-regulated holding companies and service companies.[28] The FMIA further reinforced FINMA's powers to issue a resolution stay pursuant to article 30a of the Banking Act to all contracts,[29] which in line with other initiatives will need to also be implemented through contractual arrangements,[30] such as the ISDA 2014 Resolution Protocol.[31]

Moreover, the FMIA consolidates in a single act the current rules on the disclosure of substantial shareholdings,[32] takeovers,[33] and market abuse.[34] Finally, it also amends other acts, including a far-reaching revision of the rules on international assistance in administrative matters.[35]

Nevertheless, the rules on derivative trading will, without contest, have the largest impact on market participants. Following the leader's statement of the Pittsburgh and Toronto G-20 summits,[36] the FMIA provides for four duties in connection with derivatives trading:[37]

- **clearing requirements:** certain designated OTC derivatives will have to be cleared through a licensed or recognize CCP;[38]
- **reporting obligations for derivatives:** OTC and exchange traded derivatives will have to be reported to an authorized or recognized trade repository;[39]
- **risk-mitigation obligations:** OTC derivatives that are not cleared through a CCP will be subject to risk mitigation obligations to limit operational and counterparty risks: these measures include timely confirmation, portfolio reconciliation, portfolio compression, mark-to-market valuation and margining;[40] and
- **platform trading requirement:** certain designated derivatives will have to be traded on a stock exchange or a trading platform.[41]

Another requirement regarding **position limits**[42] was added in during the legislative process to put in place enabling legislation to follow suit with the implementation of MiFID II in the EU.[43] It allows the Federal Council to impose position limits for commodities derivatives in line with international standards.[44]

All these obligations are subject to an extensive phasing-in which in some cases will last until 2020. This process should allow the creation of the necessary infrastructure to comply with these requirements and allow market participants to prepare themselves for meeting these obligations.[45] Moreover, these last two duties, the platform trading requirement and the position limits, however, will probably not enter into force before an international consensus emerges on their implementation, which is not

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22 See, e.g., René Bösch/Stefan Kramer, Schweizer Finanzmarktrecht im Umbruch – Das Finanzmarktinfrastrukturgesetz als eine der neuen Säulen, SJZ 110/2014, p. 250; Roth (n. 3), p. 609.

23 Art. 1 (2) FMIA.

24 Art. 1 (2) FMIA.

25 See 2nd Title of the FMIA (art. 4 to 92 FMIA). For an overview, see generally, Rashid Bahar/Roland Truffer, Regulation of Financial Market Infrastructures under the preliminary draft for a Financial Market Infrastructure Act, Caplaw 2014-13; Bösch/Kramer (n. 22), p. 253–254; Roth (n. 3), p. 609–610.

26 Art. 2 (a) FMIA.

27 Art. 90 and 91 FMIA; art. 27 Federal Act on Banks and Saving Institutions of 8 November 1934 (Banking Act, BankA, SR 952.0), as amended by the FMIA; art. 110 (3) FMIA.

28 Art. 2bis BankA (as amended by the FMIA).

29 See also art. 92 FMIA.

30 Art. 12 (2bis) Ordinance on Banks and Saving Institutions of 30 April 2014 (BankO, SR 952.02) (as amended by the FMIO).

31 http://assets.isda.org/media/f253b540-25/958e4aed.pdf. See, generally, Reto Schiltknecht/David Billeter, Ergänzung des ISDA-Rahmenvertrages um ein Protokoll zur Vermeidung möglicher Destabilisierung des Finanzsystems, SZW 2015, 108 ff..

32 Art. 120–124 FMIA.

33 Art. 125–141 FMIA.

34 Art. 142–143 FMIA.

35 Art. 42 FINMASA as amended by the FMIA. See, generally, Urs Zulauf, Kooperation oder Obstruktion? – 20 Jahre Amtshilfe im Finanzmarktrecht vom Börsengesetz zum FINFRAG, GesKR 2015, 336.

36 See above Section I.1.

37 The goal to impose higher capital requirements on OTC derivatives did not need to be addressed through the FMIA. Banks and securities dealers are already subject to the Ordinance on Capital Adequacy of 1 June 2012, Capital Adequacy Ordinance, CAO, SR 952.03 and insurance companies to art. 21 ff. of the Ordinance on the Supervision of Insurances of 9 November 2005, Supervisory Ordinance, OSI, SR 961.01. Botschaft FinfraG, BBl. 2014 7575.

38 Art. 97–103 FMIA.

39 Art. 104–106 FMIA.

40 Art. 107–111 FMIA.

41 Art. 112–115 FMIA.

42 Art. 118–119 FMIA.

43 See also Grenzen für Spekulanten: FinfraG im Ständerat, NZZ 2.6.2015, available at http://www.nzz.ch/wirtschaft/grenzen-fuer-spekulanten-1.18553915.

44 Art. 118–119 FMIA.

45 See also Erläuterungsbericht zur Verordnung über die Finanzmarktinfrastrukturen und das Marktverhalten im Effekten- und Derivatehandel, 25 November 2015 (Erläuterungsbericht FinfraV), p. 39 (on the clearing requirement), p. 46 (on the risk-mitigation requirement), p. 53 (reporting requirement) and p. 54 (risk-mitigation obligations).

likely until 2017 at the earliest.[46] This led Peter Nobel to dub FMIA legislation in reserve *(Gesetzgebung auf Vorrat).*[47]

Following this outline, the remainder of this article will focus on the rules on derivatives trading. After starting with their scope including cross-border issues in section II, it will examine the three duties which are due to be implemented in the near future, namely the clearing obligation (section III), the reporting obligation (section IV) and the risk mitigation requirement (section V, without considering any further the platform trading obligation or position limits). Finally, we will consider the compliance and enforcement mechanism contemplated by the FMIA (Section VI).

II. Scope

1. Products in Scope

The rules of the FMIA on derivatives trading apply to «derivatives». This term is defined under article 2 (c) FMIA as financial contracts whose value depends on one or more underlying instruments and do not constitute spot transactions. The FMIO clarifies the definition by providing some examples of underlying assets[48] and by excluding, in line with European law, physically settled electricity and gas derivatives as well as derivatives based on climate variables, freight rates, inflation rates and other official statistics, which are settled in cash only upon an event of default or the termination.[49]

The first prong of this definition is potentially extremely broad since it extends to all financial contracts[50] whose value depends on one or more instruments. The legislative materials give the following example of underlying instruments: interest-rate instrument, foreign exchange, securities, credit risks and other financial instruments including commodities and CO_2 certificates.[51] In our view, however, this term should be construed more restrictively to cover instruments whose value explicitly depends on one or more underlying instruments by way of an explicit reference to the underlying instrument, thus distinguishing a derivative from a collective investment scheme whose value, as a matter of fact, depends on the net asset value of the investments held by the collective investment scheme. Even taking this restrictive interpretation, this term remains potentially excessively inclusive, since it may also include floating-rate notes and loans, which most market participants would not qualify as a derivative, although the rate is set by reference to an index or a benchmark such as LIBOR or EURIBOR.

Regarding the second prong, the ordinance specifies the definition of spot transactions as transactions which are settled within two trading days (T+2) of the trade. It further defines as spot transactions trades that are settled within the customary or regulatory settlement cycle for such transactions of a such type.[52] Therefore, most equity transactions will be deemed spot transactions if they are settled within a T+2 cycle. However, a longer deadline may apply if sport trades are customarily settled within a longer period. A further type of spot transactions are so-called «rolling-spots», which are continuously extended, although there is neither a right nor a practice among the parties to do so.[53]

Although the leaders statement of the G-20 Summit in Pittsburgh focused on OTC derivatives trading,[54] the FMIA is not only applicable to OTC instruments but also applies to certain exchange traded instruments. This is, in particular, the case for the reporting requirement. Even the clearing requirement, although it is predominantly tailored for OTC derivatives, can be extended to traded derivatives if an international standard requires such application.[55] By contrast, the risk mitigation obligations only apply to instruments that are not traded on a trading venue (i.e., a stock exchange or a multilateral trading system, but not an organized trading system).[56] Unlike EMIR,[57] however, the delimitation between an OTC derivative and an exchange-traded instrument does not hinge on whether the trading venue is licensed or recognized in Switzerland.

Overall, the FMIA has potentially a very broad scope. It applies, for example, to futures and options, forwards and swaps,[58] as well as to contracts-for-difference (CFDs), spread betting as well as other exotic financial instruments. The FMIA and the FMIO limit, however, the

46 Art. 164 (3) FMIA regarding the platform trading requirement. See also Erläuterungsbericht FinfraV (n. 45), p. 50. See, regarding the platform trading requirement, Erläuterungsbericht Finanzmarktinfrastrukturverordnung-FINMA, 20 August 2015 (Erläuterungsbericht FinfraV-FINMA), p. 23; Bösch/Krammer (n. 22), p. 256.

47 Peter Nobel, Finanzmarktrecht: Neue Architektur – Neuer Wein?, BJM 2015, 129.

48 Art. 2 (2) FMIO.

49 Art. 2 (3) (b) and (c) FMIO. See Erläuterungsbericht FinfraV (n. 45), p. 9.

50 The legislative materials do not seem to give any operative meaning to the term «financial» in this definition. They define financial contracts as bilateral agreements. Botschaft FinfraG, BBl. 2014 7514. At the same time, the regulations seem to consider that securities although they are not bilateral instruments could also be derivatives for the purpose of the regulations, if they were not excluded in the implementing ordinances. See art. 80 (a) FMIO.

51 Botschaft FinfraG, BBl. 2014 7514.

52 Art. 4 (b) and (c) FMIO. See Botschaft FinfraG, BBl. 2014 7514.

53 Art. 4 (d) FMIO. See Erläuterungsbericht FinfraV (n. 45), p. 9.

54 Leaders' Statement (n. 4), N 13, p. 9.

55 Art. 97 (4) FMIA. According to the legislative materials, this enabling provision will be activated only if the EU would do so pursuant to art. 29 MiFIR. See Botschaft FinfraG, BBl. 2014 7567

56 See art. 97 (1) FMIA *cum* art. 26 (a) FMIA defining the term trading platform.

57 Art. 2 (7) EMIR defining an OTC derivative as a derivative that is not traded on a regulated market within the meaning of MiFID or a third-country market considered as equivalent to a regulated market in accordance with MiFID.

58 See Botschaft FinfraG, BBl. 2014 7513.

scope of the rules on derivatives trading. They provide that the following instruments are out of scope: structured products[59] and structured deposits,[60] and, more generally, securitized derivatives,[61] e.g. warrants, credit-linked notes or notes issued in connection with synthetic securitizations, which commonly use credit derivatives to achieve the same economic effect as a transfer of title to credit receivables, as well as OTC commodities derivatives that provide for physical delivery, excluding any option for either party to settle the transaction in cash.[62] The FMIA expressly specifies that securities borrowing and lending are not derivative agreements[63] and, although they are no longer expressly mentioned as being out of scope, the same conclusion holds for repurchase agreements.[64]

Furthermore, the FMIA and the FMIO provide for partial exemptions for FX forwards and swaps, provided they are settled on a payment versus payment basis. These instruments are exempted from the trading requirement,[65] clearing requirement[66] and the risk mitigation requirements, including margining,[67] but not from the reporting duties. In this respect, the Swiss regulation internationally departs from the European model and follows the U.S. one.[68] Furthermore, intra-group transactions are also subject to similar partial exemptions.[69]

2. Entities in Scope

2.1 Swiss Entities and Certain Swiss Branches of Foreign Counterparties

As a matter of principle, the FMIA is applicable to all financial and non-financial counterparties that trade in derivatives. Fundamentally, FMIA applies only to entities with a seat in Switzerland,[70] including their foreign branches.[71] Foreign entities are, as a matter of principle, not directly in scope. The Federal Council can, however, subject Swiss branches of foreign counterparties to the derivative trading rules, provided they are not subject to equivalent regulation.[72] Currently, this will most likely only be the case for branches of foreign financial counterparties.[73]

2.2 Financial and Non-Financial Counterparties

FMIA following the EMIR-model distinguishes among financial and non-financial counterparties. The term «financial counterparty» includes most regulated financial institutions, such as banks; securities dealers; insurance and reinsurance companies; holding companies of financial or insurance groups and conglomerates; collective investment schemes, fund management and asset managers for collective investment schemes; and pension funds and investment foundations.[74] The latter will, however, enjoy a longer phasing-in of their clearing obligations, allowing them to defer clearing their hedging transactions until 16 August 2017.[75]

These terms refer to clearly defined regulated entities and, thus do not leave much room for interpretation. Thus, *a contrario,* financial markets infrastructures[76] and financial intermediaries, such as investment managers, are not included in the list and will be treated as non-financial counterparties, even if they are regulated for anti-money laundering purposes and would be subject to the investment firm regime under MiFID in the EU.[77]

This approach raises, however, several questions with respect to collective investment schemes. Pursuant to the FMIA, which follows EMIR in this respect, they are treated as financial counterparties in their own right. This holds regardless whether the collective investment scheme has legal personality or not.[78] However, depending on whether the collective investment scheme is organized in a corporate form, e.g., as a SICAV, a SICAF or a limited

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59 Art. 94 (3) (a) FMIA. See also Kuhn (n. 7), p. 167, arguing that they are mainly investment instruments rather than derivatives. This dichotomy does not hold. However, structurally structured products are derivatives packaged in a bond or a note used for investment purposes. As other debt instruments, they are fungible and tradable and, consequently, present other types of risks than OTC derivatives or exchange traded derivatives.

60 Art. 80 (b) FMIO.

61 Art. 80 (a) FMIO. The term securitized refers in this context to the fungibility and tradability of the instruments, which in turn allows them to serve as intermediated securities pursuant to the Federal Act on Intermediated Securities of 3 October 2008, SR 957.1. See Erläuterungsbericht FinfraV (n. 45), p. 36.

62 Art. 94 (3) (c) FMIA.

63 Art. 94 (3) (b) FMIA. See Kuhn (n. 7), p. 167.

64 Botschaft FinfraG, BBl. 2014 7513. See Kuhn (n. 7), p. 167.

65 Art. 113 (3) (b) FMIA.

66 Art. 101 (3) (b) FMIA.

67 Art. 107 (2) (b) FMIA. This approach is consistent with BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives, March 2015 (BCBS/IOSCO, Margin requirements), available at http://www.bis.org/bcbs/publ/d317.htm, p. 7. This being said, FX transactions are subject to separate guidance from the BCBS. See BCBS, Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions, February 2013, available at http://www.bis.org/publ/bcbs241.htm.

68 Botschaft FinfraG, BBl. 2014 7571. See also Kuhn (n. 7), p. 167–168.

69 Art. 103, 111, and 115 FMIA. See below section II.3.2.

70 Art. 93 (1) FMIA.

71 Erläuterungsbericht FinfraV (n. 45), p. 35. Comp. art. 74 (2) of the draft FMIO, which expressly included such branches within the scope of the rules on derivatives.

72 Art. 93 (5) FMIA.

73 Art. 78 FMIO. The FMIA applies to financial market participants *(«Finanzmarktteilnehmer»).* The FMIO applies to counterparties in general. However, the legislative materials and the mechanics suggest that this provision only applies to branches of financial counterparties. Since FINMA is required to assess on a case-by-case basis, whether they are subject to an equivalent regulation and whether they should be subject to Swiss law. Erläuterungsbericht FinfraV (n. 45), p. 35.

74 Art. 93 (2) (a)-(g) FMIA.

75 Art. 97 (2) FMIA

76 Art. 97 (1) FMIA *a contrario.* Botschaft FinfraG, BBl. 2014 7564.

77 Art. 97 (1) FMIA *a contrario.* Botschaft FinfraG, BBl. 2014 7564; Kuhn (n. 7), p. 168.

78 Art. 76 FMIO.

partnership for collective investment, or is based on a contract, the obligations will apply either to the entity directly or in the latter case to the fund management company or its asset manager, if it is responsible for trading with derivatives.[79] In this context, the regulations do not specify whether only Swiss collective investment schemes or also foreign ones are in scope. However, notwithstanding the generic reference to the Federal Act on Collective Investment Schemes of 23 June 2006 (CISA),[80] the system of article 97 FMIA, which excludes representatives of foreign collective investment schemes, and the legislative materials[81] seem to indicate that only Swiss collective investment schemes are in scope. In this respect, the FMIA departs from the approach pursued under EMIR, which treats foreign alternative investment funds as a counterparty if they are managed by an alternative investment fund manager licensed or registered in the European Union.[82]

All other undertakings that are registered as a legal entity with the registry of commerce are subject to the FMIA as non-financial counterparties.[83] This category includes, in addition to joint-stock corporations, co-operatives and limited liability companies, also registered partnerships, limited partnerships and foundations and non-profit associations as well as sole proprietorships to the extent they trade in derivatives.[84] Under this approach, only private persons acting in a private capacity and public law entities that are not registered with the registry of commerce are out of scope of the derivatives trading of the FMIA, if they are not financial counterparties.[85]

As mentioned above, foreign entities are not in scope, otherwise than possibly in connection with foreign financial counterparties acting through a Swiss branch. This being said, the FMIA has a cross-border reach. Many duties under FMIA also apply when a Swiss entity trades with a foreign counterparty to the extent the foreign counterparty would be subject to such requirements if it had its seat in Switzerland.[86] For such situations, it is necessary to classify foreign counterparties under the FMIA. In this context, the FMIA does not define how to categorize foreign entities as a financial counterparty. In our view, FINMA's current practice in connection with licensing obligations should apply in this context too. A foreign financial counterparty is treated as such if it is licensed in its home state as one of the financial counterparties pursuant to the FMIA or if it would *mutatis mutandis* be subject to licensing requirements if it were organized under Swiss law.[87] Thus, a foreign institution which would have qualified as a bank under Swiss law if it is licensed as a bank in its home country or if it would be deemed a bank in Switzerland, had it been organized under Swiss law, regardless of its regulatory status in its home country.

With respect to foreign non-financial counterparties, the FMIO proposes to include in its scope foreign undertakings that have legal personality pursuant to the applicable law as well as trusts and similar institutions,[88] thus using a slightly different definition than the one applicable in a domestic set-up, potentially leaving registered and limited partnerships, without legal personality out-of-scope of the rules on derivatives trading if they do not fall under the definition of a foreign financial counterparty.[89]

2.3 Exempted Entities

The FMIA does not apply to all entities. Notably, it exempts the Swiss Confederation, the cantons and the communes, as well as the Swiss National Bank and the Bank for International settlement from the scope of the rules on derivatives trading under the FMIA.[90] Moreover, it also provides for a partial exemption for the following institutions, exempting them – and their counterparties – from all duties except the obligation to report trades: multilateral development banks[91] and organizations, including social security institutions, belonging to the Confederation, the cantons or the communes or for which they accept liability, to the extent they do not qualify as a financial counterparty.[92] The latter carve-out pulls not only cantonal banks and Postfinance Ltd., but also to pension funds set up by the Confederation, the cantons or the communes, fully within the scope of the rules on derivatives trading and treats them as financial counterparties in their own right. Through this exemption, nevertheless, other public entities trading in derivatives, such as utilities, remain exempt from all but the reporting requirements of the FMIA.

As with domestic entities, the FMIO provides for certain exemptions for certain foreign public institutions. First of all, mirroring closely EMIR, it exempts transactions with the following foreign entities from all but the reporting requirement: foreign central banks,[93] the European Central Bank,[94] the European Financial Stability Facility,[95] the

79 Erläuterungsbericht FinfraV (n. 45), p. 35. See also art. 72 (2) of the draft FMIO.
80 SR 951.31
81 See Botschaft FinfraG, BBl. 2014 7562.
82 Art. 2 (8) EMIR.
83 Art. 97 (3) FMIA.
84 See art. 1 (a) Ordinance on the Registry of Commerce of 17 October 2007 (ORC, SR 221.411).
85 A private banker is subject to the FMIA as financial counterparty. See Botschaft FinfraG, BBl. 2014 7562; Kuhn (n. 7), p. 168.
86 See, e.g., art. 102 FMIA (for clearing requirements).
87 See BSK BankG-Chapuis, art. 2, N 4.
88 Art. 77 (2) FMIO.
89 In our view, this conclusion does not hold for foreign collective investment schemes since they qualify as financial counterparty.
90 Art. 94 (1) FMIA.
91 Art. 93 (4) (a) FMIA.
92 Art. 93 (4) (b) FMIA.
93 Art. 79 (1) (a) FMIO. Comp. art. 1 (4) (a) EMIR. See Erläuterungsbericht FinfraV (n. 45), p. 35–36.
94 Art. 79 (1) (b) FMIO. Comp. art. 1 (4) (a) EMIR. See Erläuterungsbericht FinfraV (n. 45), p. 36.
95 Art. 79 (1) (c) FMIO. Comp. art.1 (5) (c) EMIR. See Erläuterungsbericht FinfraV (n. 45), p. 36.

Categorisation

Financial Counterparty (FC)	Non-Financial Counterparty (NFC)

• Banks and securities dealers
• Insurance and reinsurance companies
• Parent companies of a financial or insurance group or insurance conglomerate
• (Swiss) collective investment schemes, fund management companies and asset managers of CIS
• Occupational pension schemes and investment foundations
• But not: financial market infrastructures and other financial intermediaries (e.g., investment managers and investment advisors)
	Undertakings that are not FCs
	• Swiss: registration in the registry of commerce, including
	  • Sole proprietorships,
	  • Registered and limited partnerships
	  • Non-profit associations
	  • Public law institutions, if they are registered in the registry of commerce
	• Foreign institutions:
	  • Legal entities, trusts and similar institutions

Small Financial Counterparty (FC-) • 30 business day average gross exposure in all outstanding derivatives transactions < CHF 8 bn. • Modified EMIR methodology, i.e. group-wide, incl. intra-group, but including for hedging transactions	Small Non-Financial Counterparty (NFC-) • 30 business day average gross exposure in each category of derivatives < threshold (CHF 1.1. bn. for each of credit derivatives and equity derivatives; CHF 3.3 bn. for each of interest rate derivatives, FX-derivatives, as well as commodity and other derivatives) • EMIR methodology, i.e. group-wide, incl. intra-group, excluding for hedging transactions

European Stability Mechanism,[96] central governments, territorial subdivisions as well as administrative units, which are responsible for carrying out public tasks or state-owned non-profit enterprises,[97] as well as financial institutions that were established to grant development loans on non-competitive and not-for profit basis, referring indirectly to national development banks.[98]

Second, foreign central banks can claim for a complete exemption if they act within a public mandate other than for investment purposes, provided the Swiss National Bank enjoys a reciprocal treatment.[99]

2.4 Small and Non-Small Counterparties

In order to reduce the administrative burden on the smaller counterparties,[100] FMIA provides for different obligations for small and non-small counterparties. Unlike EMIR and in a similar way to the Dodd-Frank Act's end-user exemptions, the FMIA allows both financial counterparties and non-financial counterparties to enjoy the relief granted to small counterparties, although the thresholds are set differently for each group.[101]

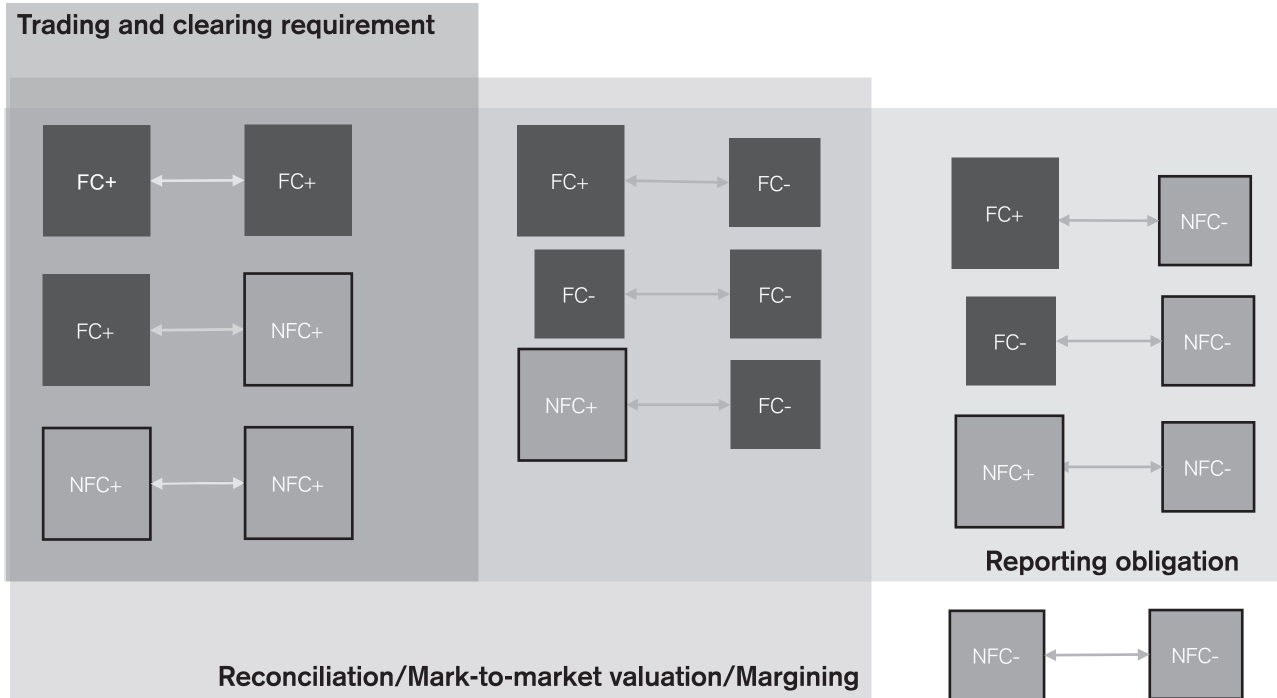
The threshold for non-financial counterparties is set for each different class of derivatives and is based on the gross notional value of their outstanding OTC derivatives during a 30 business day-period.[102] The thresholds set forth in the FMIO are largely based on the ones applicable under EMIR[103] and will be set as follows:

- CHF 1.1 billion for credit derivatives contracts;
- CHF 1.1 billion for equity derivatives contracts;
- CHF 3.3 billion for interest rate derivative contracts;
- CHF 3.3 billion for foreign exchange contracts; and
- CHF 3.3 billion for commodity derivative contracts and other derivatives.[104]

The calculation methodology is largely comparable to EMIR,[105] with the nuance that physically FX-transactions do not need to be accounted for.[106] As under EMIR, hedging transactions of non-financial counterparties can be disregarded if they are directly related to the business, the liquidity or asset management of the counterparty or its group.[107] The FMIO sets out in detail under which circumstances a transaction is deemed to be a hedging transaction. Namely, pursuant to the FMIO which follows closely EMIR,[108] hedging positions are defined to include not only direct hedging positions,[109] but also contracts entered into to protect against indirect effects of variations in interest rates, inflation, credit risks on the value of assets

[96] Art. 79 (1) (d) FMIO. Comp. art.1 (5) (c) EMIR. See Erläuterungsbericht FinfraV (n. 45), p. 36.
[97] Art. 79 (1) (e) FMIO. Comp. art.1 (5) (b) EMIR. See Erläuterungsbericht FinfraV (n. 45), p. 36.
[98] Art. 79 (1) (f) FMIO. See Erläuterungsbericht FinfraV (n. 45), p. 36.
[99] Art. 79 (2) FMIO.
[100] Roth (n. 3), p. 610.
[101] Kuhn (n. 7), p. 168; Roth (n. 3), p. 610.
[102] Art. 98 (1) FMIA.
[103] Art. 11 of Delegated Regulation 149/2013.
[104] Art. 88 (1) FMIO. The FMIO uses in this context a 1.10 CHFEUR exchange ratio.
[105] Art. 89 (a)-(g) FMIO. Cf. ESMA EMIR Q&A, www.esma.europa.eu > Markets > Post-trading/EMIR > Documents.
[106] Art. 89 (g) FMIO. See also Erläuterungsbericht FinfraV (n. 45), p. 35–36.
[107] Art. 98 (3) FMIA.
[108] Cf. art. 10 Delegated Regulation 149/2013.
[109] Art. 87 (a) FMIO.

Scope



Derivatives Trading

Scope

	FC+	NFC+	FC-	NFC-
Platform Trading	✓	✓	×	×
Clearing	✓	✓	×	×
Reporting	✓	✓	✓	✓*
Risk Mitigation				
• Timely confirmation	✓	✓	✓	✓
• Reconciliation	✓	✓	✓	×
• Dispute Resolution	✓	✓	✓	✓
• Compression	✓	✓	✓	✓
• Mark-to-market	✓	✓	×	×
• Margining	✓	✓	✓	×

and liabilities,[110] transactions that are recognized under applicable accounting standards as a hedge,[111] as well as portfolio or macro-hedging[112] and proxy-hedging transactions in accordance with international standards.[113]

Financial counterparties are, by contrast, subject to these obligations if the gross notional value of all their outstanding OTC derivatives exceeds CHF 8 billion at the level of the financial group.[114] However, unlike non-financial counterparties, they cannot disregard their hedging positions.[115] This threshold is based on the threshold applicable to the initial margin requirement,[116] although in that context, FX-transactions are in scope for determining whether the threshold was reached.

2.5 Classification

One important consequence of the FMIA will be the need to classify counterparties. To facilitate this exercise, FMIA allows entities to rely on representations of their counterparties.[117] As long as they have no indication to the contrary, counterparties will not be required to engage in due diligence procedures to classify their counterparties.[118]

3. Intra-Group Transactions

3.1 Consolidated Approach

As a matter of principle, the obligations under the FMIA, attach to a specific legal entity. However, the FMIA in many instances focuses on the economic entity, namely the group. For example, the FMIA takes a consolidated approach to counterparty classification. Consequently, positions of other entities that are part of a fully consolidated group are also accounted for in the calculation of the average gross position regardless where the entities or the parent company are incorporated.[119] Therefore, even a relatively insignificant subsidiary in Switzerland could be subject to clearing requirements as a non-small counterparty, if it belongs to a group that would qualify as a non-small financial or non-financial counterparty,[120] regardless where the group is based. It takes a slightly different consolidated approach to determine, if an entity is subject to initial margining requirements: in this context, all entities belonging to the same financial or insurance group or group of companies are taken into account.[121] Similarly, the threshold for the initial margining applies also if the amount due at the group level does not exceed CHF 50 million.[122]

3.2 Exemption for Intra-Group Transactions

At the same time, FMIA provides a certain number of exemptions for intra-group transactions. Intra-group transactions are exempt from the clearing and platform trading requirements provided that the entities are included in the same consolidation perimeter and are subject to appropriate centralized risk assessment, measurement and control processes, as long as they do not aim to avoid the application of clearing requirements.[123] With respect to non-financial counterparties, the FMIO specifies that having a professional central treasury is sufficient to satisfy the requirement to have an appropriate risk assessment, measurement and control process.[124] Additionally, as a matter of principle, intra-group trades are also exempted from the duty to exchange collateral if they satisfy the same requirements and, moreover, do not face any legal or factual obstacles (other than insolvency rules) preventing the immediate transfer of capital or repayment of liabilities.[125] However, no exemption applies for trade reporting. Intra-group transactions are therefore also reportable.

These exemptions are fairly comparable to the exemptions provided for by EMIR.[126] Unlike EMIR, this exemption does not need to be authorized or notified to a regulator,[127] thus diminishing the administrative burden for counterparties.

3.3 Transfer of Information

To enable groups of companies to comply with their requirements under the FMIA, the act expressly allows counterparties to exchange information required to comply with the FMIA within a group[128] and to provide information required by Swiss law to foreign trade repositories without seeking prior consent of clients or even giving notice.[129] This release, however, operates only to the extent the information is limited to information required by Swiss law. If counterparties intend to exchange informa-

[110] Art. 87 (b) FMIO.
[111] Art. 87 (c) FMIO.
[112] Art. 87 (d) FMIO.
[113] Art. 87 (d) FMIO.
[114] Art. 88 (2) FMIO.
[115] Erläuterungsbericht FinfraV (n. 45), p. 40.
[116] See BCBS/IOSCO, Margin requirements (n. 67). The FMIO uses in this context a 1 CHFEUR exchange ratio.
[117] Art. 97 (3) FMIA. See also Botschaft FinfraG, BBl. 2014 7567.
[118] See also Botschaft FinfraG, BBl. 2014 7567.
[119] Art. 89 (c) FMIO.
[120] Erläuterungsbericht FinfraV (n. 45), p. 40–41.
[121] Art. 100 (2) FMIO.
[122] Art. 100 (4) FMIO.
[123] Art. 103 and 115 FMIA.
[124] Art. 91 FMIO, which is also applicable for the risk mitigation requirements (art. 107 (2) FMIO) and to the platform trading requirement (art. 112 FMIO.
[125] Art. 111 FMIA. See also 107 (1) FMIO specifying that insolvency alone is not a legal impediment to the transfer of funds.
[126] See art. 4 (2) EMIR and art. 11 (5)-(11) EMIR.
[127] Comp. art. 4 (2) and 11 (5)-(11) EMIR conditioning the exemption on a notification for intra-group transactions within the EU and on an approval by the competent EU authority for intra-group transactions within an entity that is not established in the EU.
[128] Art. 96 FMIA. This provision does not, however, completely release entities from their obligations to comply with Swiss banking secrecy and data protection requirements. See Erläuterungsbericht FinfraV (n. 45), p. 37–38.
[129] See also art. 92 (4) FMIO.

tion required by foreign regulations or comply with foreign reporting requirements that have additional requirements, client consent will be necessary.[130] However, even in such circumstances, no government authorization will be required pursuant to article 271 of the Swiss Criminal Code.[131]

4. Cross-Border Transactions

4.1 «As If» Test and Unilateral Compliance

Due to the global reach of the derivatives' markets, the FMIA is bound to have a cross-border reach. Foreign entities are indirectly exposed to the FMIA when dealing with Swiss counterparties, who may be required to report, clear or trade on a platform transactions with them. With respect to the clearing, platform trading and margining requirements, FMIA applies an «as if» test and considers whether the transaction would be in scope if the foreign counterparty would have had its seat in Switzerland.[132]

This test does not apply to the reporting requirement, which is applicable unilaterally[133] and, thus, is also applicable when a Swiss counterparty deals with a foreign counterparty. The same rule applies to the other risk mitigation requirements. They should be applied unilaterally by a Swiss counterparty, even when the foreign counterparty is not subject to such obligations.[134] Considering the nature of most risk mitigation obligations, which, with the exemption of the daily valuation requirement, imply some degree of cooperation of both parties, this unilateral requirement is actually an obligation imposed on the Swiss counterparty to force its foreign counterparties to meet the requirements of Swiss law in terms of confirmation, reconciliation, dispute resolution and portfolio compression, which may prove disadvantageous to Swiss market participants.

By contrast, transactions among foreign entities are not in scope, even if they have a substantial influence on Swiss financial markets, thus marking a difference from EMIR, which applies also to transactions that have a substantial and foreseeable impact within the EU.[135]

4.2 Substitute Compliance

To facilitate compliance on a cross-border basis, the FMIA grants counterparties the right to satisfy their duties under the FMIA by applying foreign regulations that are deemed by FINMA equivalent provided they also use recognized foreign central counterparties or trade repositories.[136] This will greatly facilitate operations of multinational groups which will be thus able to channel all their clearing and reporting obligations through a single service-provider using a unified process.

However, the importance of the substituted compliance regime should not be exaggerated. It does not allow a counterparty to opt out of Swiss law. Counterparties need to continue to determine whether they have a duty under the FMIA. Substitute compliance steps in only in a second step, if and when Swiss law provides for an obligation and allows the counterparty to satisfy the requirement of Swiss law by following the process provided for by an equivalent foreign regulation.[137]

Moreover, the FMIO has restricted – without any legal basis – the scope of this exemption in purely domestic transactions: it provides that counterparties may comply with foreign regulations only if the parties or the transaction has a connection with such foreign jurisdiction and adds on that a mere choice of law does not suffice to create a nexus.[138] In our view, this exception to the rule should be handled restrictively. A nexus with a foreign jurisdiction should, thus be easily recognized, e.g., if one of the parties has significant affiliates in that jurisdiction and *a fortiori* if this affiliate assumes a role in processing the derivative trades or managing risks or if the derivatives are linked to underlying assets that are issued or traded in such jurisdiction.

4.3 Exemption for Conflicting Rules

To avoid conflicting rules, FMIA expressly exempts cross-border transactions from the clearing, platform trading and margining requirement if they are dealing with a counterparty with a seat in a jurisdiction with an equivalent regulation who is not subject to the requirement in the home country of the foreign counterparty.[139]

By virtue of this exemption, the mere fact that a derivative is subject to obligations under FMIA is not sufficient to trigger obligations for a Swiss counterparty dealing with a foreign counterparty, thus ensuring that foreign counterparties will not be subject to additional clearing, platform trading or margining obligations merely because their counterparty is Swiss and avoiding putting Swiss market participants at a disadvantage with their foreign competitors.

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130 Art. 92 (4) FMIO *a contrario*. See Botschaft FinfraG, BBl. 2014 7574. Erläuterungsbericht FinfraV (n. 45), p. 37.
131 Botschaft FinfraG, BBl. 2014 7574.
132 Art. 102 and 114 FMIA as well as art. 106 (1) FMIO. See Kuhn, Kollisionsrechtliche Aspekte der Derivateregulierung, SZW 2014, 362, p. 372.
133 Art. 104 (2) (c) FMIA.
134 Art. 106 (3) FMIO.
135 See art. 4(a) (v) EMIR (for the clearing obligation). See Kuhn (n. 132), p. 373.
136 Art. 95 FMIA. See also art. 81 (2) FMIO stating the key points that need to be satisfied to be deemed equivalent.
137 Erläuterungsbericht FinfraV (n. 45), p. 36–37
138 Art. 81 (3) FMIO. Comp. Erläuterungsbericht FinfraV (n. 45), p. 37.
139 Art. 90, 106 (2) and 111 FMIO.

III. Clearing Obligations

1. Overview

The clearing requirement is the cornerstone of the rules on OTC derivatives both globally and in the FMIA. The purpose of these requirements is to eliminate the counterparty risk from derivatives trading by relying on a CCP, dedicated financial market infrastructure, to take on this risk and deal with it through a centralized risk management process, including netting arrangements, margining and porting of client transactions.[140]

Pursuant to article 97 (1) FMIA, certain derivative contracts that are not traded on a trading venue, including derivatives traded over an exchange or a multilateral trading system, but not derivatives traded over less regulated organized trading platforms, will need to be cleared through a licensed or recognized CCP. Moreover, the FMIA empowers the Federal Council to extend this obligation to derivatives that are traded on a trading platform or on an organized trading system.[141]

2. Entities Subject to Clearing Requirements

The clearing requirements will only apply to OTC derivatives entered into among counterparties which are not small,[142] regardless whether they are financial or non-financial counterparties. By contrast, contracts with a small counterparty as well as contracts entered into between two small counterparties, regardless whether they are financial or non-financial counterparties, will not be subject to clearing obligations. Thus, FMIA, unlike EMIR, applies clearing requirements not only to small non-financial counterparties, but also to small financial counterparties.[143] This should reduce the compliance burden of pension funds and small banks, who do not have important derivative trading operations.[144]

3. Derivatives Subject to Clearing Requirements

The clearing requirements pursuant to the FMIA apply, as a matter of principle, to all OTC derivative contracts within the scope of the FMIA, with the exception of FX-swaps and forwards provided that they provide for payment versus payment settlement,[145] as well as for derivatives that are not cleared by any licensed or recognized CCP from clearing requirements.[146] However, clearing services can only be offered for sufficiently standardized OTC derivatives.[147] Even in respect of standardized derivatives, it may not make economically sense to offer clearing services if the trading volumes are not sufficient to justify the costs of the CCP.[148] Therefore, the FMIA grants FINMA a certain discretion to determine which classes of derivative contracts must be centrally cleared.[149]

Although the regulations provide for general guidelines, there is currently limited guidance as to which derivatives will be in scope,[150] other than the general expectation that FINMA will follow international standards[151] and seek to be in line with the requirements under EMIR. Based on the FMIO-FINMA, FINMA will follow both a bottom-up and top-down approach to applying the clearing requirement.[152] The bottom-up approach is likely to be the most important one in practice:[153] whenever a CCP will seek to be licensed or recognized, FINMA will determine which contracts that the CCP intends to offer will be subject to mandatory clearing.[154] From then on, if a CCP decides to expand its offering and clear additional types of derivatives, it will be required to inform FINMA,[155] who will then be able to decide whether it intends to include the new products in the scope of mandatory clearing. This approach is likely to yield most effects, since the fact that a CCP is willing to offer clearing services constitutes a credible signal that the clearing obligation will not be an impediment to trading in derivatives.

Nevertheless, FINMA seems to take the view that it can take a top-down approach and assess whether there is, from a regulatory perspective based on the principles set forth in the FMIO, a need to impose clearing obligations for instruments that are not yet cleared by a CCP.[156] FINMA's powers are, however, limited in this respect: while FINMA can by *diktat* impose a clearing obligation on market participants, it is not expressly empowered to require one or several CCPs to offer this service.[157] At the same time, given an obligation to clear, CCPs are likely to step into the breach and offer to clear the contract, knowing that market participants will need to take on their offer

140 See Kuhn (n. 7), p. 172–174.
141 Art. 97 (4) FMIA.
142 Art. 97 (2) FMIA.
143 Comp. art. 4 (1) EMIR.
144 Botschaft FinfraG, BBl. 2014 7568–7569.
145 Art. 101 (3) (b) FMIA.
146 Art. 101 (3) (a) FMIA.
147 See Botschaft FinfraG, BBl. 2014 7570–7571; Kuhn (n. 7), p. 170.
148 Botschaft FinfraG, BBl. 2014 7570–7571.
149 Art. 101 (1) FMIA.
150 See art. 101 (1) and (2) FMIA as well as art. 6 and 7 Draft FMIO-FINMA.
151 See, expressly, art. 101 (2) FMIA and art. 7 (1) *in fine* Draft FMIO-FINMA.
152 See Erläuterungsbericht FinfraV-FINMA (n. 46), p. 18.
153 Erläuterungsbericht FinfraV-FINMA (n. 46), p. 21–22
154 Art. 7 (1) Draft FMIO-FINMA.
155 Art. 7 (2) Draft FMIO-FINMA.
156 Erläuterungsbericht FinfraV-FINMA (n. 46), p. 20. This possibility is not explicitly provided for by the FMIA. Art. 7 (1) Draft FMIO-FINMA provides, however, for a general power for FINMA to determine which derivatives must be cleared through a CCP.
157 Erläuterungsbericht FinfraV-FINMA (n. 46), p. 21, seems to take the opposite view. This is, however, a substantial infringement on the economic liberty of CCPs and should in our view rest on a statutory basis.

(or use the services of a competitor) if they want to trade in such contracts. If this prediction fails to hold true, however, the obligation to clear will remain moot and market participants will be exempted from their obligation to clear their contract, if no such possibility exists.[158]

4. Phase-in

The FMIO provides for a staggered application of the clearing requirements among different categories of counterparties.

The clearing requirement applies to new transactions entered within the following deadline from the publication of FINMA's decision to subject a given class of derivatives to the clearing requirement:

- Within six months, direct participants of a licensed or recognized CCP will have to comply with the clearing requirement;[159]
- Within twelve months, CCP participant transactions with financial counterparties and transactions among financial counterparties will be subject to the clearing requirements;[160]
- Within eighteen months, the obligation will be extended to the remaining non-financial counterparties.[161]

In each case, if two different types of counterparties trade together, the clearing obligation will apply only if both counterparties are required to comply and clear their derivatives through a CCP.

Unlike EMIR, the FMIO does not foresee a frontloading regime.[162] Therefore, contracts entered into prior to these deadlines will not be subject to clearing requirements even if they remain outstanding.

IV. Reporting Obligations

1. Overview

The financial crisis brought to light how little information regulators and supervisors had regarding OTC derivatives. They had no real-time access to information allowing them to have a full picture of the market participants exposures.[163] In view of improving the transparency of OTC derivatives markets, the FMIA requires certain counterparties to report their derivative trades to a trade repository,[164] which will store the data and make it available to financial markets regulators as well as Swiss and foreign other law enforcement agencies at their request as well as in aggregated and anonymized form to the general public.[165] This data can then be used for a wide range of purposes, including not only the monitoring of systemic risks and the micro-prudential supervision of entities, which were at the heart of the initiative to regulate derivatives markets, but also more mundane tasks such as monitoring market abuse.[166]

2. Scope

As a matter of principle, all counterparties, small and non-small, financial and non-financial alike, are subject to reporting duties.[167] Moreover, the reporting duty also applies to intra-group transactions.[168] The reporting duties also apply when a counterparty enters into a derivative transaction with a party with a seat or domicile that is not in scope of the derivative market conduct rules under the FMIA.[169] Thus, a counterparty is required to report its transactions with foreign counterparties and with individuals residing in Switzerland acting in a private capacity.[170] The same applies to most exempted entities[171] with the exception of the Swiss federal, cantonal or communal governments, the Swiss National Bank, the Bank for International Settlement as well as certain central banks and government debt management agencies.[172] The statute only provides for one other exemption: transactions among small non-financial counterparties,[173] which should, in our view a *majore minus,* also include transactions between small non-financial counterparties and individuals residing in Switzerland.

Departing from the G-20 Leaders' Statement[174] but following the lead set by EMIR,[175] the reporting duty as stated above applies indiscriminately to OTC and exchange-traded derivatives.[176] Furthermore, it also applies to FX-forwards and swaps,[177] leaving only derivatives

[158] Art. 101 (3) (a) FMIA. The existence of this provision suggests that the argument that FINMA can order CCPs to clear new categories of derivatives does not hold.
[159] Art. 85 (a) FMIO.
[160] Art. 85 (b) FMIO.
[161] Art. 85 (c) FMIO.
[162] Comp. art. 20 EMIR. See Erläuterungsbericht FinfraV (n. 45), p. 39.
[163] Financial Stability Board, Implementing OTC Derivatives Market Reform, 25 October 2010, p. 11.
[164] Art. 104 (1) FMIA.
[165] See art. 76–79 FMIA. See Kuhn (n. 7), p. 180.
[166] See Botschaft FinfraG, BBl. 2014 7514; Authorities' access to trade repository data, August 2013, available at http://www.bis.org/cpmi/publ/d110.pdf, p. 5–6; Financial Stability Board, Implementing OTC Derivatives Market Reform, 25 October 2010, p. 11. See also Kuhn (n. 7), p. 180.
[167] See Botschaft FinfraG, BBl. 2014 7573.
[168] See Botschaft FinfraG, BBl. 2014 7573.
[169] Art. 92 (1) FMIO. See Botschaft FinfraG, BBl. 2014 7573.
[170] Art. 104 (1) FMIA.
[171] See Botschaft FinfraG, BBl. 2014 7573; Erläuterungsbericht FinfraV (n. 45), p. 41.
[172] See Botschaft FinfraG, BBl. 2014 7573.
[173] Art 104 (3) FMIA.
[174] See above Leaders' Statement (n. 4), N 13, p. 9.
[175] See art. 9 (1) EMIR.
[176] See Botschaft FinfraG, BBl. 2014 7573.
[177] Comp. art. 101 (3) (b), 113 (3) (b) and 107 (2) (b) FMIA.

that are not in scope of the derivative trading rules untouched.[178]

3. One-Sided Reporting Model

Following the model of the US Dodd-Frank Act[179] and unlike EMIR,[180] the FMIA provides for the one-sided reporting duties. This system allows to minimize the compliance burden by avoiding multiple reporting.[181]

The reporting system under the FMIA is based on the following waterfall:

- When the **trade is centrally cleared,** the CCP is required as a matter of principle to report the trade.[182] If the parties clear their transactions through a foreign CCP, who is not required to report, the counterparties remain obliged to report the trade.[183] In such a case, it is the party that is closest to the CCP who is required to report.[184]
- When a **financial counterparty** trades with a **non-financial counterparty,** the financial counterparty is required to report the trade.[185]
- When two financial counterparties or two non-financial counterparties trade with each other, whichever **party is not a small counterparty** is required to report the trade.[186]
- When both parties are either small counterparties or non-small counterparties, the **selling party is subject to the reporting requirement.**[187] Considering the practical difficulty in defining who is the selling party, the FMIO allows the parties to define by contract who will be required to report the trade.[188]
- This being said, in a cross-border setting, the Swiss counterparty is always subject to the reporting requirement, when the foreign counterparty is not required to report the trade under applicable law.[189]

The reporting requirement can be delegated to a third party.[190] This allows one counterparty to assume the responsibility to carry out the reporting for the other or for groups of companies to task one entity with filing the reports for all other group entities. In such a case, the client consent and notification requirements applicable under data protection regulations and, for banks and securities dealers, FINMA-Circular 2008/7 Outsourcing banks apply.[191] However, relying on the exemption for intra-group communication,[192] this delegation will not require prior client consent if the information is limited to the requirements of Swiss law.

4. Content, Format and Timing of Reporting

Under the FMIA, counterparties are allowed to satisfy their duties either by reporting to a Swiss trade repository or to a recognized foreign trade repository.[193] Importantly from a practical perspective, counterparties are not required to inform and seek the consent of their clients when reporting a transaction to a Swiss or foreign trade repository based on the requirement of the FMIA.[194] Client consent is required only if a counterparty provides additional client data to a foreign CCP, e.g., because it needs to also comply with foreign regulations,[195] and, even then article 271 of the Swiss Criminal Code does not apply.[196]

Although unsurprisingly, the implementing ordinance requires more than disclosing the identity of the counterparty, the type of transaction, its term, notional value, price, execution date and currency, the scope of the reporting obligations under the FMIA are slightly less extensive than under EMIR. The sheer number of data required is impressive. From a quantitative perspective, FMIA requires the disclosure of 79 data fields[197] whereas EMIR requires 26 data fields on the counterparty and 59 transaction related items.[198] In particular, the FMIA does not require parties to disclose the beneficial owner[199] or use a legal entity identifier (LEI) or a Business Identifier Code, but also recognizes other identifiers.[200] This being said, the standardization of the counterparty and product identifiers are central elements to allow trade repositories

[178] See above section II.1
[179] See 17 CFR § 45.8.
[180] Art. 1 (3)-(5) Commission Delegated Regulation (EU) No 148/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories, Official Journal of the European Union, L52/1 of 23 February 2013; See Kuhn (n. 7), p. 179.
[181] Botschaft FinfraG, BBl 2014 7573. See also Kuhn (n. 7), p. 179
[182] Art. 104 (4) FMIA.
[183] Art. 104 (4) FMIA.
[184] Art. 92 (2) FMIO.
[185] Art. 104 (2) (a) FMIA.
[186] Art. 104 (2) (b) (1) FMIA.
[187] Art. 104 (2) (b) (2) FMIA.
[188] Art. 92 (3) FMIO. See Erläuterungsbericht FinfraV (n. 45), p. 42. The U.S. regulation follows this approach by default. See 17 CFR § 45.8 (d) (1) and (2).
[189] Art. 104 (2) (c) FMIA.
[190] Art. 104 (5) FMIA.
[191] See Erläuterungsbericht FinfraV (n. 45), p. 42.
[192] Art. 96 FMIA. See above section II.3.2.
[193] Art. 104 (1) FMIA.
[194] Art. 92 (4) FMIO. See above section II.3.3.
[195] Art. 104 (4) FMIA. See above section II.3.3
[196] See above section II.3.3.
[197] Annex 2 to FMIO.
[198] Annex 1 to Delegated Regulation No 148/2013.
[199] See Erläuterungsbericht FinfraV (n. 45), p. 43. Comp. item 11 of Delegated Regulation No 148/2013.
[200] Item 2, Annex 2 to FMIO. Erläuterungsbericht FinfraV (n. 45), p. 43. Comp. art. 3 Commission Implementing Regulation No 1247/2012 of 19 December 2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories, Official Journal of the European Union, L 352/20 of 21 December 2012.

to achieve the objectives of global standard setters and regulators.[201] It is therefore likely that if Swiss counterparties do not use LEI, the regulatory pressure will increase.

Counterparties are required to report any new derivative transaction as well as any change or termination of transaction on the following business day.[202] Although this deadline is in line with EMIR,[203] it remains well below the deadlines applicable in the United States, which can be as short as 15 minutes.[204] In this context, closing a position by entering into the opposite transaction is deemed to constitute a new transaction rather than a change, thus potentially leading to double counts of closed positions.[205]

5. Phase-in

Reporting duties will start applying to all open derivative positions within the following period after the first trade repository will have been licensed or recognized by FINMA:

- **Six months:** trades due to be reported by non-small financial counterparties and CCPs;[206]
- **Nine months:** trades due to be reported by small financial counterparties and non-small non-financial counterparties;[207]
- **Twelve months:** in all other cases.[208]

Furthermore, trades carried out through a trading venue or an organized trading systems will enjoy an additional six months to be reported.[209]

V. Risk Mitigation

1. Overview

The FMIA provides, as a back-up, for several requirements for counterparties to mitigate risks related to OTC derivatives that are not subject to a clearing requirement.[210] First of all, it sets out certain obligations to mitigate operational risks by requiring counterparties to confirm their trades in a timely manner,[211] by regularly reconciling portfolios,[212] by agreeing to a pre-defined dispute resolution process[213] and, finally, by carrying out a portfolio compression.[214] Second, it requires all counterparties to value on a daily basis their derivatives through a mark-to-market process, or at least through a mark-to-model process.[215] Finally, to minimize credit risks, it obliges counterparties to exchange collateral.[216]

The risk mitigation obligations apply to all OTC derivatives that are not subject to the clearing requirement. However, trades with counterparties that are out of scope of FMIA,[217] FX-swaps and forwards,[218] and derivatives that are voluntarily cleared through a licensed or recognized CCP are also exempted from the risk mitigation requirements.[219]

2. Operational Risks

2.1 Timely Confirmation

FMIA requires both parties to confirm derivatives transactions at the latest on two business days following the trade (T+2) or, for trades entered into after 16:00 three days after (T+3).[220] Small counterparties have, however, another day to confirm their trades and thus can confirm up to T+3 or T+4 for trades entered into after 16:00.[221] The same rules for complex transactions,[222] a term which is not defined in the regulations. The Swiss rules, thus, depart with the EMIR standard[223] and grant market participants an additional business day, considering this requirement is more realistic.[224]

To gain a sense of perspective, before the financial crisis, the New York Fed and other regulators, including the Swiss Federal Banking Commission tackled the backlog of derivatives confirmations.[225] In 2006, the New York Fed had achieved an arrangement with the major derivative dealers by which they agreed to create an environment for them to confirm their trades on a T+5 business day basis, where the trades are executed electronically, and on T+30

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201 Kuhn (n. 7), p. 178.
202 Art. 105 (1) FMIA.
203 Art. 9 (1) EMIR.
204 17 CFR § 45.3 (b) (1) (i). See Kuhn(n. 7), p. 174.
205 Although art. 90 (1) and (2) of the draft FMIO were not included in the final version of the FMIO, there is no support for another interpretation of these actions.
206 Art. 130 (1) (a) FMIO.
207 Art. 130 (1) (b) FMIO.
208 Art. 130 (1) (c) FMIO.
209 Art. 130 (2) FMIO.
210 Art. 107 (1) FMIA.
211 Art. 108 (a) FMIA.
212 Art. 108 (b) FMIA.
213 Art. 108 (c) FMIA.
214 Art. 108 (d) FMIA.
215 Art. 109 FMIA.
216 Art. 110 FMIA.
217 Art. 107 (2) (a) FMIA.
218 Art. 107 (2) (b) FMIA
219 Art. 107 (2) (c) FMIA.
220 Art. 108 (a) FMIA and art. 95 (1) and (2) FMIO.
221 Art. 95 (3) FMIO.
222 Art. 95 (3) FMIO.
223 Art. 12 (1) Delegated Regulation 149/2013.
224 Erläuterungsbericht FinfraV (n. 45), p. 44.
225 See generally, U.S. Government Accountability Office, Credit Derivatives: Confirmation Backlogs Increased Dealer's Operational Risks but were Successfully Addressed after Joint Regulatory Action, June 2007, available at http://www.gao.gov/new.items/d07716.pdf.

calendar days otherwise.[226] This achievement was praised as a successful achievement in June 2007.[227]

From a practical perspective, this confirmation does not need to be in writing and can be exchanged electronically.[228] Moreover, counterparties can diminish the administrative burden and agree to opt into a deemed confirmed regime and provide that a confirmation is deemed to be accepted, if the other party does not object.[229]

2.2 Portfolio Reconciliation

All counterparties, with the exception of small non-financial counterparties, must agree on a procedure to reconcile the material terms of OTC derivatives and their valuation.[230] This should allow parties to identify sources of dispute early on and address them as soon as possible. The agreement must be in place before they start trading[231] and, thus, will most likely need to be integrated in a master agreement of some kind, although this agreement is not subject to any formal requirement.[232]

The portfolio reconciliation process will need to cover the key terms of a transaction and its valuation.[233] This process can be carried out by the counterparties directly or by a third party appointed by them.[234] This reconciliation process must be carried out:

- on a **daily basis** for counterparties which have more than 500 outstanding OTC transactions open with each other;
- on a **weekly basis** for counterparties, which have at any time during a given week between 51 and 499 outstanding OTC transactions with each other; and
- on a **quarterly basis** for counterparties that have 50 or less outstanding transactions with each other.[235]

2.3 Dispute Resolution

Mirroring closely the EU regulations, the FMIO requires parties to set up a process to identify, record and monitor disputes between the parties.[236] The record should cover the duration of the dispute, the counterparty and the amount which is disputed.[237] Moreover, the dispute resolution system should provide for a specific process for disputes that could not be solved within five business days.[238] However, it does not require counterparties to inform the regulator of larger disputes that are outstanding for a longer period of time,[239] although depending on its materiality such a duty could be deduced from article 29 (2) FINMASA. Finally, the FMIO specifies that the counterparties must agree on applicable law and jurisdiction.[240]

2.4 Portfolio Compression

All counterparties are, as a matter of principle, required to carry out a portfolio compression at least twice a year.[241] Portfolio compression seeks to identify among outstanding transactions, whether some are redundant or unnecessary, without modifying the overall exposure.[242] This is, however, a complicated and costly exercise, therefore, it will apply only to counterparties that have more than 500 outstanding OTC transactions that are not cleared through a CCP.[243] In addition to this quantitative limitation, this obligation is also subject to a qualitative requirement to avoid costly but futile exercises. It only applies to the extent it contributes to diminish the overall counterparty risk,[244] thus substantially limiting the scope of this obligation.

The FMIO provides additional guidance on how to construe this relatively vague concept and specifies that it should be read as meaning that portfolio compression does not contribute to a risk reduction if (a) the portfolio includes no or only a limited number of positions that can be compressed,[245] (b) the portfolio compression is prejudicial to the efficacy of internal risk management processes and controls,[246] or more generally if (c) the costs

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226 Senior Management of Bank of America, N.A Barclays Capital, Bear, Stearns & Co., BNP Paribas, Citigroup, Credit Suisse, Deutsche Bank AG, Dresdner Kleinwort, Goldman, Sachs & Co., HSBC Group, JP Morgan Chase, Lehman Brothers, Merrill Lynch & Co., Morgan Stanley, Société Générale, UBS AG, Wachovia Bank, N.A., letter to Timothy Geithner, President, Federal Reserve Bank of New York, 21 November 2006. https://www.newyorkfed.org/medialibrary/media/newsevents/news/markets/2006/an061121c.pdf. See generally, U.S. Government Accountability Office (n. 225).

227 See generally, U.S. Government Accountability Office (n. 225).

228 Erläuterungsbericht FinfraV (n. 45), p. 44.

229 Art. 95 (4) FMIO.

230 Art. 108 (b) FMIA. See also art. 13 Delegated Regulation 149/2013.

231 Art. 96 (1) FMIO.

232 Erläuterungsbericht FinfraV (n. 45), p. 44.

233 Art. 96 (2) FMIO.

234 Art. 96 (3) FMIO.

235 Art. 96 (4) FMIO. In this context, physically settled FX forwards and swaps do not need to be taken into account. Art. 96 (5) FMIO. Unlike the EU regulations, the Swiss rules do not apply to small non-financial counterparties (art. 108 (b) FMIA *in fine*) and, thus, the thresholds provided for by art. 13 (3) (b) Delegated Regulation 149/2013 are moot.

236 Art. 97 (2) (a) FMIO. Comp. art. 15 (1) (a) Delegated Regulation 149/2013.

237 Art. 97 (2) (a) FMIO. Comp. art. 15 (1) (a) Delegated Regulation 149/2013.

238 Art. 97 (2) (b) FMIO. Comp. art. 14 (1) (b) Delegated Regulation 149/2013.

239 Comp. art. 14 (2) Delegated Regulation 149/2013 requiring a notice for disputes regarding a derivative, its valuation or the exchange of collateral for an amount or value that is higher than EUR 15 million and that is outstanding for more than 15 business days.

240 Art. 97 (1) FMIO.

241 Art. 108 (d) FMIA. Comp. art. 14 Delegated Regulation 149/2013.

242 See Financial Stability Board, Implementing OTC Derivatives Market Reform, 25 October 2010, p. 37; Kuhn (n. 7), p. 175.

243 Art. 108 (d) FMIA.

244 Art. 98 (1) FMIO.

245 Art. 98 (2) (a) FMIO.

246 Art. 98 (2) (b) FMIO.

of portfolio exercise are disproportionate in comparison with the expected reduction of the counterparty risk.[247]

If a counterparty determines that a portfolio compression exercise is not appropriate, it should be documented and reviewed every six months.[248]

3. Daily Valuation

Financial and non-financial counterparties, to the exclusion of small counterparties,[249] are required to mark-to-market the value of their outstanding contracts on a daily basis.[250] If the market conditions do not permit a mark-to market, they are required to use appropriate and recognized marking-to-model approaches.[251] The FMIO clarifies, following the EU-regulatory standards, both when market conditions prevent a marking to model and what criteria should be used for marking to model in such a case.[252]

4. Exchange of Collateral

Clearing through a CCP has its limits: it supposes a certain degree of standardization that is and will not be available for all classes of OTC derivatives.[253] To reduce counterparty risks even on the OTC market, all counterparties, to the exclusion of small non-financial counterparties,[254] are required to exchange collateral.[255] Following the market practice, the regulations distinguish among initial margin and variation margin. Initial margin is supposed to cover the risk of a loss in the event of close-out following a default of the counterparty.[256] Variation margin, by contrast, should cover against variation in the market value of the contract.[257]

Although the EU did not finalise the delegated regulations regarding the exchange of collateral,[258] the FMIO takes a head start and implements the statutory requirement by relying on the international standards sponsored by the Basel Committee and IOSCO,[259] on calculation of initial margin requirements,[260] the quality requirements[261] and haircuts.[262]

Even after the end of the long phasing-in period, the initial margin requirements will only apply to counterparties who have aggregate outstanding OTC derivatives that are not cleared through a CCP (including FX-derivatives and swaps that are otherwise out of scope of the FMIA) at the end of the months of March, April and May of a given year in excess of CHF 8 billion (including FX-forwards and swaps).[263] In such a case, the obligation will apply for a year starting on the following September. Even then, initial margin does not need to be exchanged if the amount due on a consolidated basis is less than the threshold of CHF 50 million.[264] Although no such rule applies to variation margins, collateral needs to be exchanged only if the outstanding amount exceeds the *de minimis* amount of CHF 500,000.[265]

From then on, the amount of initial margin due will need to be reassessed regularly no less than every 10 business days,[266] whereas variation margin will need to be measured and exchanged on a daily basis.[267]

To ensure the effectiveness and enforceability of the collateral, the FMIA expressly provides that the enforcement of collateral provided as initial and variation margin pursuant to the FMIA is protected from a stay resulting from the commencement insolvency proceeding,[268] thus expanding the scope of an exception that applied only to

247 Art. 98 (3) FMIO.
248 Art. 98 (1) FMIO.
249 Art. 109 (2) FMIA. Their counterparties are, however, not released from their obligation to value. Large financial or non-financial counterparties are required to mark-to market or mark-to-model their transactions also when they deal with small counterparties. Erläuterungsbericht FinfraV (n. 45), p. 48.
250 Art. 109 (1) FMIA.
251 Art. 109 (3) FMIA.
252 Art. 99 (1) and (2) FMIO regarding the conditions under which a mark-to-model valuation can be applied and art. 99 (3) FMIO on the requirements applicable to the model. See art. 13 (3) (b) Delegated Regulation 149/2013.
253 Kuhn(n. 7), p. 174.
254 Art. 110 (1) FMIA.
255 Art. 110 (1) FMIA.
256 Art. 100 (1) (a) FMIO. See also BCBS/IOSCO, Margin requirements (n. 67), p. 12.
257 Art. 100 (1) (b) FMIO. See also BCBS/IOSCO, Margin requirements (n. 67), p. 12.
258 See, generally, ESMA, EBA, EIPA, Joint Committee of the European Supervisory Authorities, Second Consultation Paper: Draft Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012, June 2015, available at https://www.eba.europa.eu/documents/10180/1106136/JC-CP-2015-002+JC+CP+on+Risk+Management+Techniques+for+OTC+derivatives+.pdf and Consultation Paper: Draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012, April 2015, available at https://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf.
259 BCBS/IOSCO, Margin requirements (n. 67).
260 Comp. art. 103 FMIO and Annex 3 with BCBS/IOSCO, Margin requirements (n. 67), p. 14–15 and Appendix A.
261 Comp. art. 104 (1) FMIO and BCBS/IOSCO, Margin requirements (n. 67), p. 16–19. The FMIO expressly treats money market funds as eligible collateral, although they are not on the list. This is, however, not a departure from the BCBS/IOSCO standards, which are expressly stated to be open-ended. See also Erläuterungsbericht FinfraV (n. 45), p. 48.
262 Comp. art. 105 FMIO and Annex 4 with BCBS/IOSCO, Margin requirements (n. 67), p. 17–19 and Appendix B.
263 Art. 100 (2) FMIO. The idea is to capture only key market participants. BCBS/IOSCO, Margin requirements (n. 67), p. 9.
264 Art. 100 (4) FMIO. See also BCBS/IOSCO, Margin requirements (n. 67), p. 10. However, the FMIO does not allow counterparties to deduce the threshold from the margin requirement. Comp. BCBS/IOSCO, Margin requirements (n. 67), p. 10 and Erläuterungsbericht FinfraV (n. 45), p. 46.
265 Art. 100 (3) FMIO.
266 Art. 101 (1) FMIO.
267 Art. 100 (2) FMIO.
268 Art. 110 (3) FMIA

banks and securities dealers,[269] to collateral in book entry securities[270] and to full-title security, but not to pledges in other forms of property granted by other types of debtors.

At the same time, the FMIA requires parties to ensure the segregation of collateral exchanged pursuant to FMIA[271] and, going beyond the BCBS/IOSCO standards, expressly prohibits re-hypothecation of collateral provided as initial margin,[272] without, however, restricting the re-use of variation margin.[273]

5. Phase-in

The requirements regarding a timely confirmation, portfolio reconciliation, dispute resolution and portfolio compression will apply within the following periods as of the entry into force of the FMIO: (a) twelve months: trades between non-small counterparties and their trades with small financial counterparties;[274] and (b) eighteen months: all other trades. Furthermore, the valuation requirements will apply from twelve months after the entry into force of the FMIO.[275] The duty to exchange collateral will not apply to transactions that were already open upon the entry into force of the FMIO. Moreover, the exchange of collateral will be phased-in gradually:

- Counterparties with an outstanding non-cleared OTC derivative position at the end of March, April and May 2016 in excess of CHF 3,000 billion will need to exchange variation margin and initial margin from 1 September 2016 onwards;[276]
- All other counterparties will need to exchange variation margin for contracts entered after 1 March 2016 from 1 September 2017 onwards; as of that date, the initial margin requirements will step in for counterparties with an outstanding non-cleared OTC derivative position at the end of March, April and May 2017 in excess of CHF 2,250 billion;[277]
- Counterparties with an outstanding non-cleared OTC derivative position at the end of March, April and May 2018 in excess of CHF 1,500 billion will need to exchange initial margin generally from 1 September 2018 onwards;[278] and
- Counterparties with an outstanding non-cleared OTC derivative position at the end of March, April and May 2019 in excess of CHF 750 billion will need to exchange initial margin generally from 1 September 2019 onwards.[279]

VI. Compliance and Enforcement

1. Documentation Requirements

To ensure compliance, financial and non-financial counterparties are required to document in writing the processes through which they ensure the implementation of their obligations to (a) clear derivatives with a CCP; (b) determine the thresholds; (c) report transactions (d) mitigate risks; and (e) trade derivatives on a trading venue.[280] Non-financial counterparties that do not trade in derivatives are exempt from these obligations if they document their decision not to trade in derivatives through a written resolution.[281]

2. Audit

2.1 Financial Counterparties

Compliance by financial counterparties will be monitored as part of the general compliance framework with the regulatory auditor auditing and reporting any breaches to their regulator,[282] who may then either address the issue as part of the overall supervisory process or initiate a formal enforcement procedure. If the regulator is aware that a criminal provision of the FMIA was breached, it must report the matter to the Federal Department of Finance,[283] who can then initiate administrative criminal proceedings leading to a fine of up to CHF 100,000.[284]

2.2 Non-Financial Counterparties

The FMIA extend this dual-supervision model to non-financial counterparties, albeit without conferring to FINMA the jurisdiction to initiate enforcement measures against non-financial counterparties. Statutory external auditors will be required to control, as part of their normal audit cycles, whether non-financial counterparties comply with their obligations under the FMIA and, in particular, their documentation duties.[285]

The level of scrutiny and reporting will depend on the type of company and its risk profile.[286] An auditor appointed to carry out a full audit pursuant to article 728

[269] Art. 27 BankA.
[270] Art. 31 (2) of the Federal Act on Intermediated Securities of 3 October 2008, SR 957.1.
[271] Art. 102 (1) and (3) (a) and (b) FMIO. BCBS/IOSCO, Margin requirements (n. 67), p. 7.
[272] Comp. art. 102 (2) FMIO and BCBS/IOSCO, Margin requirements (n. 67), p. 21–22. See Erläuterungsbericht FinfraV (n. 45), p. 47.
[273] Erläuterungsbericht FinfraV (n. 45), p. 46.
[274] Art. 131 (1) (a) and (b) FMIO.
[275] Art. 131 (2) FMIO.
[276] Art. 131 (5) (a) FMIO.
[277] Art. 131 (5) (b) FMIO.
[278] Art. 131 (5) (c) FMIO.
[279] Art. 131 (5) (d) FMIO.
[280] Art. 113 (1) FMIO.
[281] Art. 113 (2) FMIO.
[282] Art. 29 (2) FINMASA
[283] Art. 38 (3) FINMASA.
[284] Art. 150 FMIA
[285] Art. 114 (1) FMIO.
[286] Art. 114 (2) FMIO.

CO is required to provide a positive assurance[287] and is required to include their findings in their comprehensive report to the board of directors pursuant to article 728b CO.[288] Whereas in the event of a limited review pursuant to article 729 CO, the auditors are only asked to provide a negative assurance[289] and, departing from the general rule, must inform the responsible body, e.g., the board, of their findings.[290]

If they identify any violations, they must document this finding in their report and set a deadline for the correction of such breach.[291] At the end of the deadline, if the company did not cure the breach as well as in the event of repeated breaches, the audit company is required to report the case to the Federal Department of Finance,[292] who can then initiate administrative criminal proceedings leading to a fine of up to CHF 100,000.

2.3 Administrative Criminal Sanctions

The derivative trading rules are backed by an administrative criminal sanction, pursuant to which whoever breaches intentionally their clearing obligations, their reporting duties, the risk mitigation obligations or their platform trading duties are liable to a fine of up to CHF 100,000.[293] This leaves negligent breaches out of the reach of the Federal Department of Finance, although – at least in the non-regulated sector – an auditor will only report a case if the company failed to take appropriate measures within the deadline it set, thus somewhat complicating a negligence defense. Furthermore, the criminal provision only addresses four of the five cores obligations. It does not extend to the documentation and retention requirements, which are removed from the review from an administrative criminal law perspective.

VII. Conclusion

With the entry into force of the FMIA and its implementing ordinances on 1 January 2016, Switzerland has made a big step to being recognized as equivalent to EMIR. If the exercise yields a positive result and convinces the European experts making this determination, this will facilitate the access for Swiss market participants to the European market and enable Swiss corporates to benefit from the European intra-group exemption when dealing with their affiliates in the EU.

However, the implementation of the FMIA has, as a matter of fact, only just begun: a number of significant milestones need to be reached before it is fully applicable. It remains indeed to be seen when and how FINMA will apply the clearing requirement, what derivatives will be subject to clearing requirements and which trade repositories will seek to be authorized or recognized in Switzerland. Counterparties will have to prepare themselves to complying with the requirements of the FMIA. In sum, many challenges lay ahead. Nevertheless, Switzerland will have caught up with its international peers and the strategic goal of the regulation will have been achieved.

Taking a step back, the question that lingers around is whether this additional regulation with all its complexity and compliance burden will achieve its goals of decreasing systemic risk and creating a transparent environment for derivatives trading. While the benefits of certain measures such as the timely confirmation, portfolio reconciliation or compression, are tangible, the jury is still out on others: it seems that notwithstanding the added transparency of the reporting duties, the infrastructure still does not fully allow regulators to see the big picture of the derivative markets.[294] In other words, more reforms are going to come after 1 January 2016.

[287] Erläuterungsbericht FinfraV (n. 45), p. 52.
[288] Art. 114 (3) FMIO.
[289] Erläuterungsbericht FinfraV (n. 45), p. 52.
[290] Art. 114 (4) FMIO.
[291] Art. 114 (5) FMIO.
[292] Art. 114 (7) FMIO.
[293] Art. 150 FMIA.
[294] See Kuhn (n. 7), p. 180–181.