Central Counterparty Clearing – Impact of the New Financial Market Regulation

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- **Central counterparties**
- **Major market participants direct clearing members**
- **Licensing requirements**

1. Overview of the New Financial Market Regulation

The new Federal Financial Market Infrastructure Act (FinfraG) has introduced specific clearing requirements for certain trades / products.

Going forward, the majority of OTC derivatives transactions will need to be cleared (mandatory clearing).

Central Counterparties (CCP) will become vital to the financial market infrastructure following the implementation of new regulations that require standardized derivatives to be cleared. As a result of their systemic importance, clearing houses are required to develop recovery plans to avert a threat to their viability and to ensure they can maintain the continuity of critical services without requiring the intervention of regulatory authorities or resorting to taxpayer's money.

2. Key Points for Market Participants

To facilitate the clearing of certain derivative transactions, the parties to a transaction must enter into a so called client clearing agreement with a clearing member that incorporates and modifies certain client clearing standard terms. A precise negotiation of the respective terms in such a client clearing agreement is crucial because underlying master agreements (i.e. ISDA Master Agreements or Swiss Master Agreements for over-the-counter (OTC) derivative instruments) and trade confirmations will be amended by the terms of the client clearing agreement for cleared derivative transactions.

Pestalozzi Rechtsanwälte AG
Feldeggstrasse 4
CH-8008 Zürich
T +41 44 217 91 11
zrh@pestalozzilaw.com

Pestalozzi Avocats SA
Cours de Rive 13
CH-1204 Genève
T +41 22 999 96 00
gva@pestalozzilaw.com

pestalozzilaw.com

Some major market participants are going to be direct clearing members and will offer a service to smaller market participants to become the client of a member of an authorised or recognised CCP (in order to fulfil clearing requirements under the new regulatory regime). The clearing member and the small market participants sign the clearing client addendum, which will apply to those transactions under the underlying trading document (OTC master agreement) and which will be cleared by the clearing member through a CCP service in line with the new law and regulation.

CCPs must comply with the general licensing requirements in line with with FinfraG.

CCPs must ensure an appropriate organization, an effective risk management and an internal control system.

CCPs must comply with capital- and liquidity requirements of the draft FINIG as well as the rules of conduct of the draft FIDLEG.

CCPs are systemically important and must fulfil restrictive obligations, for instance, with regards to the capital requirements, liquidity and risk diversification.

Under FinfraG, very similar clearing requirements are expected as implemented by EMIR in the EU. The details are included in delegated regulations (specifying the parameters of clearing requirements).

Robert Furter

Senior Counsel
Attorney at law

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 91 55
robert.furter@pestalozzilaw.com

