Clearing Obligation: Revised FMIO-FINMA

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Introduction

Standardized OTC interest-rate and credit derivatives are the first derivative products that are subject to clearing. The relevant categories of affected products (i.e., derivatives that are not traded over a stock exchange or a multilateral trading facility) that are, for the first time, subject to a clearing obligation have been determined by the Swiss Financial Market Supervisory Authority ("FINMA") and are listed in Annex 1 of its Financial Market Infrastructure Ordinance ("FMIO-FINMA"). This clearing obligation contains the duty to clear trades of certain categories of OTC derivatives through central counterparties ("CCP") that FINMA has either authorized or recognized. The categories are aligned with European law to ensure equivalence – derivatives in Switzerland are predominantly cross-border trades, which are often carried out with market participants whose registered offices are in the EU. For implementing the clearing obligation, FINMA has revised Annex 1of the FMIO-FINMA.

Addressees of the clearing obligation

The clearing obligation affects financial counterparties that are not small ("FC+") and non-financial counterparties that are not small ("NFC+"), both of which have their registered offices in Switzerland. FC+ and NFC+ furthermore must comply with the clearing obligations in cross-border business with foreign trading partners. This duty does not apply to transactions with small counterparties or for transactions between such counterparties.

Fulfillment of the clearing obligation

The clearing obligation is met by the FC+ and NFC+ by using CCP. The CCP functions as a contract party between a derivative's buyer and seller. The CCP guarantees in this way that the obligations of the buyer and the seller are fulfilled, whereby FINMA basically needs either to authorize the CCP in case it is a Swiss CCP or to recognize the CCP in case it is a foreign CCP. Trading through a CCP reduces the default counterparty risk to ensure financial market stability. The CCPs which are authorized respectively recognized by FINMA can be found on the FINMA homepage in a periodically updated list in the section 'Stock exchange and financial market infrastructures'.

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Categories of OTC derivatives subject to the clearing obligation

In General

Pursuant to article 101 para. 1 of the Swiss Financial Market Infrastructure Act ("FMIA"), FINMA determines the derivatives that must be cleared via a CCP. Due to this provision, FINMA has revised Annex 1 of the FMIO-FINMA. As most Swiss market participants trade derivatives on a cross-border basis (in particular with EU market participants), the Swiss regulations concerning derivatives trading are oriented primarily to EU law (i.e., EMIR and associated implementation provisions), including the FMIO-FINMA Annex 1.

OTC Interest-rate derivatives

According to Annex 1 of the FMIO-FINMA, the categories of interest-rate derivatives, which are subject to a clearing obligation, comply with these categories in the EU in terms of the most important trade currencies. Interest-rate derivatives that are settled in Swiss francs (CHF) are currently not subject to the clearing obligation. However, FINMA has announced that a clearing obligation for interest-rate derivatives with CHF settlement might be introduced at a later stage (depending on the international legal development and global standards).

OTC Credit derivatives

Also, the credit derivatives categories subject to the obligation duty, according to the FMIO-FINMA Annex 1, are aligned with these categories, subject to the EU clearing obligation.

Transitional periods

Annex 1 of the FMIO-FINMA entered into force on 1 September 2018. At that time the transitional periods in respect of the duty to clear derivatives transactions via authorized or recognized CCPs started running. These transitional periods range from six to 18 months and depend on the respective derivative category in question.

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