Trading Venues – Impact of the New Financial Market Regulation

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- **Regulated market, multilateral tradingfacilities (MTF) and systematic internalizers (SI)**
- **New form of central counterparties (CCP), organized trading facilities (OTF) and systematic internalizes (introduced by FinfraG)**
- **Off-exchange dark liquidity trading**

1. Current Regulatory Regime

Trading venues are regulated market, multilateral trading facilities (MTF) and systematic internalizers (SI) that facilitate trading and risk management by providing execution services and related liquidity provision services. They have been a critical component of the Swiss financial market infrastructurewith a certain degree of systemic relevance. But while regulating trading venues was one of the most ambitious elements of EU securities and market regulation in the post-crisis era so far, trading venues have not been the most important target of the Swiss regulator. Currently, trading venues are governed bythe Stock Exchange Act (SESTA) and a significant degree of self-regulation to ensure that trading venues have an organizational structure appropriate to its operations, administration and supervision activities.

2. Overview of the New Financial Market Regulation

The Financial Market Infrastructure Act (FinfraG) will introduce a new form of central counterparties (CCP), organized trading facilities (OTF) and systemic internalizes (SI). Only non-standardized financial products shall be permitted for trading over-the-counter without any intermediation going forward. Thus, besides mandatory clearing, the importance of trading venues and organized trading facilities will increase considerably with the implementation of the new Swiss regulatory regime.

3. Selected Key Points for Trading Venues

Similar to the EU approach (with its significant number of delegations to the European Securities and Market Authority (ESMA)), an important part of the regulation will be delegated to the Federal Council (and further to the regulator) regarding classified rules (administrative rulebook). FinfraG mandates the Federal Council to determine which financial products are going to be required to be traded via a central counterparty, a trading venue, or a trading facility by considering the degree of standardization, their liquidity, their trading volumes and the availability of pricing information in the given category as well as the counterparty's risks associated with the respective transaction. Noteworthy is that the requirement to trade via a trading venue also applies if the Swiss market participant's foreign counterparty was subject to this requirement if it had its registered office in Switzerland. Intra-group transactions, currency swaps and forward transactions as well as derivatives not admitted for trading by any applicable trading venue or facility will be excluded from the aforesaid duty.

The focus at this stage of the legislative process will beto determine the exact content of the delegated rulemaking. We have to await the complete set of publications of the regulatory technical standards / regulations (to be expected at the end of this year) to assess which derivatives will be subject to these trading obligations. A good indication can be attained by looking at the ESMA-proposed Binding Technical Standards (BTSs) for the EU market. It is safe to say that a majority or even all derivatives that are delegated for clearing and trading via platforms under the European Market Infrastructure Regulation (EMIR) are purportedly also going to be subject to clearing, trading via a trading venue, or an operator of an organized trading facility in Switzerland.

One of the concerns of investors is the future treatment of off-exchange dark liquidity (i.e. using a private forum for trading securities) to prevent an unnecessary impact on their pricing. The market structure changes in FinfraG are designed to limit the use of dark liquidity and to extend pre- and post-trade transparency. Other than central counterparties, trading venues will register all of its orders and transactions, as well as transactions reported to it, chronologically. It shall also indicate the time, identity of the participants, the products traded, the volume and the price.

FinfraG also strengthens pre-trade transparency for transactions via trading venues that obliges firms to publish the bid and offer prices and the size of their trading positions. Pre-trade transparency requirements shall be exempted for high-volume transactions taking into account recognized international standards, foreign legal developments and trades that are executed by the Swiss National Bank (SNB). Trading via an organized trading facility is also subject to transparency requirements, which can be exempted. Pre-trade transparency shall, however, only apply where specifically regulated by the Federal Council, again in line with recognized international standards for extending the publication duty to pre-trading transparency.

Thus, market participants must know how their derivatives business will be affected by the regulatory changes. Both the specifications and classifications will be subject to a delegated rule-making, which has yet to be published. EMIR and ESMA's technical standards are an indication and can be used as a reference. It is not yet entirely clear, however, to what extent Switzerland will follow the EU regarding the exact classifications of the delegated rule-making. MiFID II and MiFIR pursue the goal of less self-regulation for the operation of trading platforms, whereas the Swiss legislator considers that self-regulation of trading platforms is worthwhile to be pursued. The distinctions will be found in the details of the classifications and will require a deeper analysis of the FINMA rule-making once reliable drafts are available. Nonetheless, market participants will prepare themselves to either be required to clear their derivatives via a central counterparty, trade via a trading venue, or an organized trading facility.

OTC trading will be limited to non-standardized derivatives between certain counterparties, below certain thresholds and as a FinfraG-exemption. Swiss market participants would be wise to get familiar with the regulatory changes regarding their traded products to be able to continue trading without any implementation-delay and, at the same time, to align their business strategies with new regulatory requirements.

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