



Swiss uncleared margin rules and the impact of European regulations on the exchange of collateral in Switzerland

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- New uncleared margin obligations in Switzerland
- Provisional equivalence of certain EU rules
- Amendment of Swiss uncleared margin rules in the light of the final EU Level 2 Regulation
- Swiss implementation of the BCBS-IOSCO margin requirements

1. Uncleared margin obligations in Switzerland kicking-in noticeably

Under the new Swiss regulatory regime, parties to OTC derivatives will be required to exchange variation margin and initial margin going forward. In order to avoid any unnecessary regulatory gaps between Switzerland and foreign regulatory regimes in foreign jurisdictions, it was the legislator's goal before and during the consultation process for the Financial Market Infrastructure Act (FMIA) and the Financial Market Infrastructure Ordinance (FMIO), both effective since January 2016, to align the Swiss uncleared margin rules with those of the EU and subsequently with the relevant international standards.

2. Provisional equivalence of certain EU rules

Since the EU Regulatory Technical Standards (RTS) relating to derivatives trading were not finalized when the Swiss uncleared margin rules entered into force in January 2016, FINMA recognized specific EU rules as provisionally equivalent.

Further, FINMA (mandated by FMIO) extended the transitional periods for the exchange of collateral, as specified in the FINMA Guidance 01/2016.

As a result of such advice and guidance, counterparties subject to Swiss uncleared margin rules have had the opportunity to meet the requirements under the EU rules provisionally, provided that the relevant conditions were met (currently and until 1 September 2017 only financial counterparties triggering the relevant thresholds (i.e. the largest Swiss banks) have been in-scope).

3. Final Level 2 Regulation under EMIR for Non-cleared OTC Derivatives

In the EU, the final RTS have now been published in the Official Journal of the European Union. The

final RTS entered into force on 4 January 2017 and by 1 March 2017, all EU in-scope counterparties will be obliged to post variation margin with a phased-in implementation for initial margin from 1 September 2017 through to 1 September 2020.

The final RTS went through several amendments as compared with the initial draft reviewed and referenced by the Swiss legislator during the legislative procedure of FMIA and FMIO.

4. Amendment of uncleared margin rules in FMIO

In order to align the current FMIO-uncleared margin rules with the final EU Level 2 Regulation, the FMIO-section on risk mitigation obligations will be amended. The amendment has been announced by the Federal Department of Finance on the online portal of the Swiss government.

The revised Art. 100 et seq. FMIO will go into consultation in March and are expected to be finalized in June 2017.

Although there will be changes to the risk mitigation rules, they are not considered to be "substantial" and shall be limited to the alignment to the Level 2 requirements under EMIR.

Nonetheless, clarification with respect to the full set of final rules depends on the final provisions of FMIO that are expected to enter into force in the course of 2017.

Given that the amendment of FMIO is only necessary to align the Swiss risk mitigation provisions with EU law, the final EU Level 2 Regulation provides a good and substantial idea as to how and to what extent each active Swiss OTC derivatives party, except for small non-financial counterparties, will be required to change their legal documentation, set up their collateral systems and train their collateral operation units.

5. Swiss implementation of the BCBS-IOSCO margin requirements

According to the FMIO explanatory report, the "Margin Requirements for Non-Centrally Cleared Derivatives document issued by the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions in March 2015 (BCBS-IOSCO Margin Requirements)" create the framework of the Swiss uncleared margin rules. However, the Swiss legislator has interpreted some of the international standards more conservatively and – partly – more flexibly.

On the one hand, cash and non-cash collateral collected as initial margin from a customer may not be re-hypothecated, re-pledged or re-used to a third party in Switzerland.

On the other hand, Swiss law provides for provisions that ensure the enforceability of contractual agreements regarding the liquidation of collateral, but does not specifically require rigorous and robust dispute resolution procedures in place between the parties before the onset

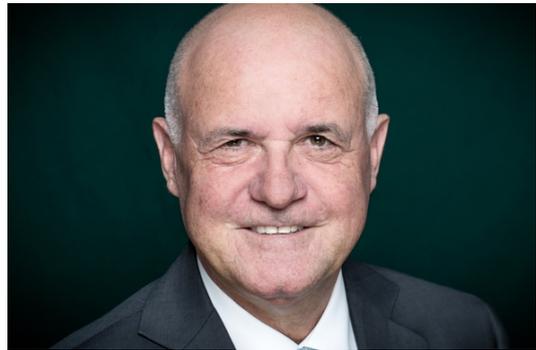
of a transaction. According to the BCBS-IOSCO Margin Requirements, however, parties to derivatives contracts should have rigorous and robust dispute resolution procedures in place with their counterparty before the onset of a transaction.

Thus, the Swiss implementation of the BCBS-IOSCO Margin Requirements can have the effect that some differences to other regulatory regimes may occur with more or less evident influences in practice and in cross-border trading relationships. The legal and commercial relevance of such differences will need to be observed in the future to avoid any expensive pit-falls.

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