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SCHELLENBERG WITTMER

JANUARY 2014

Newsletter



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BANKING & FINANCE

Draft Proposal for a New Swiss Federal Act on Financial Market Infrastructures

Published at the end of 2013, the draft proposal (**Proposal**) for a Federal Act on Financial Market Infrastructures (**FINFRA**) provides for new rules for financial market infrastructures (**FMIs**) and OTC-derivatives.

1 BACKGROUND

In respect of **FMIs**, the FINFRA aims at consolidating legal provisions in one act and at bringing such rules in line with current regulatory requirements. Moreover, the FINFRA introduces a regulation of **OTC derivatives transactions** (derivatives entered into in the over the counter markets, i.e. off-exchange). The proposed regulation of derivatives trading is modeled after the respective EU rules (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 [**EMIR**]), and aims at implementing the proposals made by the G-20 in 2009 at its Pittsburgh summit. The FINFRA also incorporates the rules on **disclosure of shareholdings, public takeovers** (takeover law) as well as **insider trading and market manipulation**, as currently included in the Swiss Stock Exchange Act (**SESTA**), which will eventually be repealed.

2 FINANCIAL MARKET INFRASTRUCTURES

2.1 GENERAL

According to the Proposal, the FINFRA will include rules on the organization and the operation of **FMIs**. FMIs are:

- **Trading venues** (see 2.3);
- **Central counterparties** (see 2.4 and 4.3);
- **Central securities depositories** (including securities settlement systems);
- **Trade Repositories** (see 4.4.); and
- **Payment Systems**.

2.2 LICENSING AND SUPERVISION

FMIs need to be **licensed** by the Swiss Financial Markets Supervisory Authority (**FINMA**), except for payment systems and – subject to a licensing requirement that is yet to be determined by the secondary legislation – organized trading facilities not allowing for multilateral trading. Licenses will only be granted if the **licensing conditions** are met. An operator of a **financial market infrastructure** may not operate any other FMIs (a limited exemption is available for central securities depositories).

Financial market infrastructures that the Swiss National Bank (**SNB**) considers to be of **systemic importance** will have to fulfill further conditions. What is "systemic importance" in this context corresponds to the definition included in the current articles 20 and 20a of the National Bank Ordinance (**NBO**). In order to assess whether a central counterparty, a central securities depository or a payment system qualifies as systemically important, the SNB considers **various factors** such as the transaction types and the volumes and amounts of the transactions cleared or settled through the respective FMI.

FINMA is the competent supervisory authority with respect to FMIs that are **not considered to be of systemic importance**. With respect to FMIs deemed of **systemic importance**, a dual supervisory system shall apply with the SNB monitoring the system and FINMA supervising the institutions (complementary model).

Furthermore, the draft FINFRA provides for rules under which **foreign** trading venues, central counterparties and trade repositories, before granting access to Swiss participants, may be **recognized** by FINMA under the conditions set out in the FINFRA.

In addition to specifying under what conditions and how the license of a FMI can be revoked, the FINFRA also includes provisions dealing with the **insolvency** of FMIs. In this context, the FINFRA refers to the relevant provisions of the Swiss Federal Banking Act (**BankA**) which are applicable by analogy unless the FINFRA contains more specific provisions.

2.3 TRADING VENUES

While the SESTA distinguishes between stock exchanges and exchange-like trading facilities, the new FINFRA refers to **stock exchanges, multilateral trading facilities** and **organized trading facilities**. In this respect, the Proposal is modeled after the classifications as provided for in the relevant EU rules[1].

The Proposal continues to adhere to the principle of self-**regulation** (subject to supervision by FINMA), as originally provided for by the SESTA. Trading venues are required to issue, *inter alia*, a **regulation regarding the admission of trading participants**. According to the Proposal, not only securities dealers, but also other FINMA-licensed institutions, FINMA-licensed foreign trading participants as well as the SNB can be admitted as trading participants.

2.4 CENTRAL COUNTERPARTIES

According to the Proposal, a **central counterparty** is a facility having general terms and conditions and acting as buyer *vis-à-vis* each seller and as seller *vis-à-vis* each buyer regarding financial instruments traded on one or multiple markets. The purpose of central counterparties is to **reduce counterparty risk**, which should increase the stability of the financial system. Due to the concentration of the insolvency risk within a central counterparty, such counterparties are subject to regulation.

3 SECURITIES DEALERS

In addition to regulating stock exchanges and exchange-like trading facilities, the SESTA currently also regulates licensing requirements for **securities dealers**. The FINFRA will, according to the Proposal, no longer provide for the categories of securities dealers acting as underwriters, derivatives issuers, (own account) dealers and market makers. Separate licenses for such activities will no longer be needed. Instead, such activities will be reserved to duly licensed banks and entities licensed under SESTA to act as securities brokers (*Kundenhändler*).

> "FINFRA seeks to comprehensively regulate OTC derivatives trading in Swiss financial market law."

4 DERIVATIVES TRADING (ENTERING INTO AND CLEARING TRANSACTIONS)

4.1 AFFECTED DERIVATIVES

The new regulations will affect to **all kinds of OTC derivatives**, irrespective of what documentation is used (for example ISDA Master Agreements or Swiss Master Agreements published by the Swiss Bankers Association). They will not apply to repo transactions and securities lending transactions.

4.2 SCOPE OF APPLICATION

The proposed new rules shall apply to all counterparties **domiciled in Switzerland** (including their foreign branches, but – except where the Federal Council were to decide otherwise for a specific jurisdiction – excluding Swiss branches of foreign counterparties). Furthermore, the new regulation shall not apply to the Swiss Confederation, Cantons, municipalities, the SNB and the Bank for International Settlements.

As regards its personal scope of application, FINFRA distinguishes between **financial** and **non-financial counterparties. Financial counterparties** are, among others, banks, securities dealers, insurance and re-insurance companies, pension funds, investment trusts (*Anlagestiftungen*), fund management companies and certain other companies licensed under the Collective Investment Schemes Act (CISA). Legal entities that do not qualify as financial counterparties are treated as **non-financial counterparties. Small** financial and non-financial counterparties are exempted from certain requirements.

The notification obligation and (except as set out below under 4.5) the risk mitigation obligation apply to all financial and non-financial counterparties. However, the clearing obligation only applies to derivatives between counterparties which both exceed certain **thresholds**, as applicable to certain **categories** of OTC derivatives. Such thresholds and derivatives categories are yet to be defined by Federal Council and FINMA in the secondary legislation. For these purposes, as

[1] See Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (**MiFID**) and the respective proposal for its revision, under which it is to be split into a directive (**MiFID II**) and a regulation (**MiFIR**).

provided for in EMIR, whether a non-financial counterparty is below the relevant threshold and therefore exempted from the clearing obligation, shall be determined on the basis of the outstanding gross notional amounts regarding the relevant class of derivatives (excluding hedging positions). To the extent that a threshold is exceeded with respect to one class of derivatives, this will lead to a clearing obligation with respect to all derivatives subject to the clearing obligation (see below under 4.3). However, unlike EMIR, the Proposal also introduces a category of **small financial counterparties**. These include counterparties entering into derivatives exclusively for the purpose of hedging risks arising from the client-facing mortgage business. Such small financial counterparties will be exempted from the clearing obligation.

4.3 CLEARING OBLIGATION (DUTY TO CLEAR TRADES THROUGH CENTRAL COUNTERPARTIES)

The clearing obligation applies to all **standardized** derivatives in the sense of the FINFRA, entered into among financial and non-financial counterparties (except where a counterparty to a derivative is a small financial or non-financial counterparty). The clearing obligation entails that such transactions are cleared through a **central counterparty** licensed or authorized by FINMA (see 2.4 above). Intra-group trades are – under certain conditions – exempted. What derivatives are "standardized" must yet be determined by FINMA. To the extent the clearing obligation applies, a central counterparty will step into the contractual relationship between the original parties of the contract.

Like EMIR, the FINFRA will require that transactions entered into with a foreign counterparty must be cleared, to the extent that such clearing obligation would also exist if the counterparty was domiciled in Switzerland.

> "With respect to derivatives trading FINFRA will introduce clearing, notification and risk mitigation obligations into Swiss law."

4.4 NOTIFICATION OBLIGATION

Financial and non-financial counterparties as well as central counterparties must report certain information regarding derivatives transactions (including the relevant characteristics of the transactions) to a **trade repository** licensed or recognized by FINMA (see 2.1 above). Such notification obligation will not only apply to "standardized" derivatives but to any type of OTC derivative (including intra-group transactions). A delegation to third parties is possible (for instance to the counterparty). The trade repositories must collect the data and grant access to authorities to the extent provided for by law. What information must be reported has yet to be determined by the Federal Council in the secondary legislation, but should at least include the identity of the parties, the nature, the due date, the nominal value, the price, the settlement date and the currency of the transaction.

4.5 RISK MITIGATION OBLIGATION

Derivative transactions that are not cleared through a central counterparty licensed or recognized by FINMA are subject to certain **risk mitigation obligations**. Such obligations include the timely exchange of confirmations and the establishment of appropriate portfolio reconciliation and dispute resolution procedures. Financial and non-financial counterparties (except for small financial and non-financial counterparties) must value derivatives on a daily basis based on current market prices. Furthermore, financial and non-financial counterparties (except for small non-financial counterparties) must provide collateral for the outstanding exposures (except for intra-group transactions under certain conditions). The details of such obligations are yet to be determined by the Federal Council.

4.6 PLATFORM TRADING OBLIGATION

The Proposal further introduces a legal basis to oblige financial and non-financial counterparties (excluding small financial and non-financial counterparties) to trade "standardized" derivatives on a **trading venue** (see 2.3 above) licensed or recognized by FINMA. Under certain conditions, intra-group transactions are excluded from such obligation. According to the transitional provisions of the Proposal, however, such platform trading obligation shall only enter into force when this is appropriate in light of international developments (in particular taking into account the developments in the EU under MiFID II and MiFIR).

5 FURTHER PROVISIONS

The provisions of the SESTA regarding the **disclosure of shareholdings, public takeovers** as well as **insider trading and market manipulation** will be transferred into the FINFRA without any substantial changes.

Moreover, the Proposal also provides for the modification of numerous other federal laws, including amendments ancillary to the rules of the FINFRA. For instance, it is proposed to include new rules on **administrative assistance** into the Financial Market Supervision Act (FIMSA).

6 OUTLOOK

The consultation period (*Vernehmlassungsfrist*) regarding the Proposal will last until 31 March 2014. It is expected that the revised Proposal will then be published shortly and be discussed in Parliament which makes an entry into force in 2015 appear possible.

Provided that the provisions regarding derivatives trading enter into force as proposed, market participants will have to **take action** in different respects. In particular, it will be necessary:

- to evaluate whether a market participant qualifies as a **financial or non-financial counterparty** or, as the case may be, a small financial or non-financial counterparty;
- to **modify contracts** in order to comply with the risk mitigation obligations (for instance similarly to the protocols published by ISDA in relation to the implementation of EMIR);
- to agree with the counterparty how the reporting obligations will be complied with (including aspects regarding waivers of secrecy obligations or a delegation);
- to confirm with the counterparty whether it is subject to a clearing obligation or not; and
- to enter into the relevant agreements with a clearing broker (on the basis of the market standard documentation), to the extent that the clearing obligation is applicable.

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The content of this Newsletter does not constitute legal or tax advice and may not be relied upon as such. Should you seek advice with regard to your specific circumstances, please contact your Schellenberg Wittmer liaison or any of the following persons:



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