
Financial Market Infrastructure Act (FMIA)

Key information for Pictet Group clients

July 2020



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G20 Summit in
Pittsburgh in
September 2009

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Introduction

G20 Summit in Pittsburgh in September 2009

The 2007-2008 financial crisis highlighted how important it is for the over-the-counter (OTC) derivatives market to run smoothly in order to ensure the stability of the financial system. In response to a call by the G20 in 2009, a series of regulatory proposals have been initiated to strengthen the solidity of the OTC markets. The purpose of these new worldwide regulations is to plug certain gaps brought to light by the crisis, particularly in terms of risk management and transparency.

G20 Leaders Statement:

Improving over-the-counter derivatives markets: All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the FSB (Financial Stability Board) and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse.

The four objectives resulting from the Pittsburgh Summit:

- OTC derivative contracts should be traded on exchanges or electronic trading platforms
- OTC derivative contracts should be cleared through central counterparties
- OTC derivative contracts should be reported to trade repositories
- The risk of non-centrally cleared contracts should be mitigated

Implementation of these principles at international level (US and EU):

In the United States

Dodd–Frank Wall Street Reform and Consumer Protection Act 2010 (Pub.L. 111–203).

In the European Union

European Market Infrastructure Regulation (EMIR), EU Regulation No.648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, Official Journal L 201 of 27 July 2012, 1-59.

In Switzerland

The Financial Market Infrastructure Act (FMIA) is the piece of Swiss Federal legislation relating to implementation of these principles internationally.

Chapter 1

The Financial Market Infrastructure Act (FMIA)

The Swiss Federal Act on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading [known as the Financial Market Infrastructure Act (FMIA)], together with the Implementing Ordinance on Financial Market Infrastructure (OFMI), made significant changes to OTC derivatives transactions. The main aims of the new law are to enhance the transparency of OTC derivatives transactions, reduce counterparty risk, and improve market integrity and supervision.

1.1 New obligations introduced under the FMIA

The FMIA introduced a number of new obligations that counterparties trading OTC derivatives will have to comply with. The FMIA first distinguishes three fundamental obligations:

- a) **The obligation to clear trades through a central counterparty (*clearing*)**
- b) **The obligation to report to a trade repository (*reporting*)**
- c) **Obligations to mitigate risk (*risk mitigation*), which can be broken down as follows:**
 - Valuation
 - Confirmation
 - Portfolio reconciliation
 - Portfolio compression
 - Dispute resolution
 - Collateral posting

The application of an obligation to a specific counterparty will depend on that counterparty's classification pursuant to the FMIA and on the type of derivatives that it handles.

1.2 Derivative products and transactions covered by the FMIA

WHAT IS MEANT BY “DERIVATIVES” UNDER THE FMIA OF 1 JANUARY 2016?							
	Cash management, commodities ¹	Securities & structured products	Derivatives in the form of deposits	Futures/ forward transactions and swaps	Securities financing transactions ²	Standardised derivatives (ETDs) ³	Other OTC derivatives
Classification as counterparty (thresholds)	X	X	X	X ⁴	X	X	✓
Clearing	X	X	X	X	X	X	✓
Reporting	X	X	X	✓	X	✓	✓
Portfolio reconciliation	X	X	X	X	X	X	✓
Dispute resolution	X	X	X	X	X	X	✓
Valuation reporting	X	X	X	X	X	X	✓
Collateral posting	X	X	X	X	X	✓	✓
Bilateral margining	X	X	X	X	X	X	✓
Organised trading facilities	X	X	X	X	X	X	✓

X is not considered a derivative

✓ is considered a derivative

¹ Contracts settled by physical delivery are not considered derivatives.

² Securities lending and borrowings (SLBs) and repurchase agreements (repos) are not considered derivatives.

³ Exchange-traded derivatives (ETDs), including listed futures and options, are not subject to the same regulatory requirements as OTC derivatives under the FMIA. ETDs are already subject to margin requirements (collateral posting) by stock exchanges.

⁴ Derivatives not subject to clearing under FMIA Art. 101, para. 3, letter b, are not included in the calculation.

1.3 Financial-market participants covered by the FMIA

Any counterparty trading OTC derivatives is required by the FMIA to classify itself in accordance with its status. The FMIA distinguishes between financial counterparties (FCs) and non-financial counterparties (NFCs).

Financial counterparties (FCs) include:

- banks,
- securities dealers ,
- insurance and reinsurance companies,
- parent companies of a financial or insurance group,
- fund-management companies and asset managers of collective investment schemes,
- collective investment schemes,
- occupational pension schemes and investment foundations.

Companies that are not financial counterparties are deemed to be non-financial counterparties (NFCs). Natural persons (individuals) are expressly excluded from the legal framework of the FMIA's provisions.

Chapter 2

Classification of market participants

Market participants are classified according to thresholds that are used to define the array of different obligations applicable to the various counterparties. These obligations are explained in 4.1 below.

It is important for counterparties to monitor these thresholds constantly: any change in threshold might well involve new and/or different obligations becoming applicable.

2.1 Thresholds applicable to financial counterparties (FCs)

The FMIA makes a distinction between two types of financial counterparties: large financial counterparties (FC+) and small financial counterparties (FC-). The assessment is made on the basis of the gross average positions of OTC derivatives transactions outstanding, which are compared to a threshold. This threshold stands at 8 billion Swiss francs (CHF8bn) and does not take currency swaps or forward transactions into account. This threshold is generally met by large and medium-sized banks and parent companies of a group. Companies in groups that are made up of more than one legal entity and required to present consolidated financial statements must include each legal entity's positions when calculating the CHF8bn threshold. Please note that EMIR, the corresponding EU regulation, makes a distinction between large and small financial counterparties based on its own thresholds. These are different from those applicable under FMIA. For more information, please refer to our FAQ document for "EMIR – European Markets Infrastructure Regulation" at www.group.pictet/market-regulations.

2.2 Thresholds applicable to non-financial counterparties (NFCs)

For NFCs, if the following thresholds applicable to the gross average positions of OTC derivatives outstanding are not exceeded, the NFC is deemed to be 'small' (NFC-):

Credit derivatives	CHF 1.1 bn
Equity derivatives	CHF 1.1 bn
Interest-rate derivatives	CHF 3.3 bn
Currency derivatives	CHF 3.3 bn
Commodities derivatives and other derivatives	CHF 3.3 bn

Chapter 3

FMIA obligations by classification of participants

3.1 Summary of obligations by category of entity

WHICH FMIA OBLIGATIONS ARE APPLICABLE DEPENDING ON AN ENTITY'S CLASSIFICATION?				
Obligation	FC+	NFC+	FC-	NFC-
1) Clearing	✓	✓	<i>n.a.</i>	<i>n.a.</i>
Calculation of thresholds per derivative category (NFCs)	<i>n.a.</i>	✓	<i>n.a.</i>	✓
Calculation of CHF8bn threshold (FCs)	✓	<i>n.a.</i>	✓	<i>n.a.</i>
2) Reporting to trade repository	✓	✓	✓	✓
3) Risk mitigation	✓	✓	✓	✓
Confirmation of contractual terms	✓	✓	✓	✓
Portfolio reconciliation	✓	✓	✓	<i>n.a.</i>
Dispute resolution	✓	✓	✓	✓
Portfolio compression	✓	✓	✓	✓
Daily valuation	✓	✓	<i>n.a.</i>	<i>n.a.</i>
Collateral posting	✓	✓	✓	<i>n.a.</i>
4) Documentation of procedures	✓	✓	✓	✓
5) Other obligations	✓	✓	✓	✓
Platform trading	✓	✓	<i>n.a.</i>	<i>n.a.</i>
Position limits	✓	✓	✓	✓
Hedging exemption	<i>n.a.</i>	✓	<i>n.a.</i>	✓

FC+ Large financial counterparty

FC- Small financial counterparty

NFC+ Large non-financial counterparty

NFC- Small non-financial counterparty

n/a Not applicable

3.2 Key points for small counterparties

In general, small counterparties (FC-/NFC-) trade their OTC derivatives with a large financial counterparty (FC+), such as Banque Pictet & Cie SA. Reporting in this case is performed by the largest counterparty (hierarchical system), i.e. here Banque Pictet & Cie SA.

In addition, NFCs- are exempt from the obligation to exchange collateral (FMIA Art. 110, para. 1) and from the obligation to have portfolio-reconciliation procedures (FMIA Art. 108, letter b).

In general, currency swaps and forward transactions are exempt from the obligations to mitigate risk (FMIA Art. 107).

Chapter 4

Details of the obligations imposed under the FMIA

4.1 Clearing through a central counterparty (CCP)

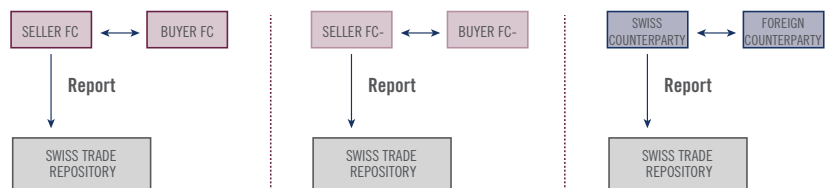
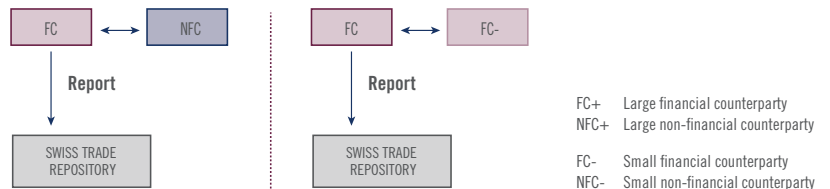
This obligation, which is geared towards reducing counterparty risk, involves transferring the transaction to a central counterparty (CCP) authorised or recognised by FINMA. The CCP interposes itself between the two original counterparties to a transaction, thus becoming the counterparty for both parties. The CCP then assumes all the risks and obligations related to the contract vis-à-vis the two original counterparties. FINMA is currently preparing a list of derivatives subject to the central clearing obligation. Under the FMIA, this obligation only applies to the FC+ and NFC+ categories. The FC- and NFC- categories are thus exempt from the obligation to clear their derivatives centrally.

4.2 Reporting to a trade repository (TR)

This obligation to report OTC derivative transactions and ETDs applies both to derivatives traded over the counter (OTC) and to exchange-traded derivatives (ETDs). All transactions must be reported to a trade repository authorised or recognised by FINMA. The conclusion, modification or termination of a derivatives transaction must be reported no later than the following business day. Pursuant to the FMIA, the reporting obligation is incumbent on the counterparty highest in the hierarchy that has been defined (unilateral reporting obligation, see table below). Consequently, when a FC- or NFC- counterparty deals with Banque Pictet & Cie SA, Banque Pictet & Cie SA, as the counterparty highest in the hierarchical system, assumes the obligation to report the transaction in question.

When it comes to derivatives transactions with a foreign counterparty, if the foreign counterparty does not report the transaction to a FINMA-accredited trade repository, then the counterparty based in Switzerland is required to report the transaction.

WHICH ENTITY INVOLVED IN A TRANSACTION HAS THE REPORTING OBLIGATION UNDER THE FMIA?



Buyer = 'buyer' side of the transaction

Seller = 'seller' side of the transaction

In the case of an interest-rate swap (IRS), the 'seller' side is the payer of the variable rate spread

4.3 Need to obtain a Legal Entity Identifier (LEI)

In December 2015, the Federal Council decided that Switzerland would participate in setting up a global legal entity identifier system. To do so, the Federal Council authorised the Federal Department of Finance to become a full member of the regulatory oversight committee (ROC) of the Legal Entity Identifier (LEI) system. In Switzerland, this identification number will be used in connection with the obligation to report derivatives transactions under the FMIA to a trade repository.

Therefore, each counterparty involved in a derivatives transaction must obtain an LEI from a local operating unit (LOU) responsible for issuing LEIs, ensuring their registration, renewal and other services. The LOUs serve as the primary interface for legal entities wishing to obtain an LEI.

The official list of LOUs can be found on the following website:
http://www.lei.org/publications/gls/lou_20131003_2.pdf

4.4 Risk mitigation

The provisions below only apply to OTC derivatives transactions not cleared by a central counterparty. Under the FMIA, risk-mitigation obligations do not apply to currency swaps or forward transactions.

Valuation

This obligation requires a daily valuation of the market price of OTC derivatives transactions outstanding that are not cleared by a central counterparty. FCs– and NFCs– are not covered by this obligation. If trading is done with Banque Pictet & Cie SA, then Banque Pictet & Cie SA has the daily valuation obligation.

Confirmation

All counterparties must confirm their OTC derivatives transactions, that are not cleared through central counterparties, by a given deadline. Where the transaction is between an FC–/NFC– and Banque Pictet & Cie SA: the confirmation must be given by D+3. The counterparties may agree to “implied confirmation”: a transaction is deemed confirmed if one counterparty’s confirmation is not contested by the other counterparty by a given deadline. In certain transactions, Banque Pictet & Cie SA may require confirmation in return from the client (positive confirmation).

Portfolio reconciliation

Portfolios of uncleared OTC derivatives transactions must periodically be reconciled in order to ensure that there are no discrepancies (valuation difference or differences in the material terms of the contract). How often reconciliation is done depends on the number of transactions outstanding between the counterparties. For 50 or more derivatives transactions pending, reconciliation must be done once a quarter. Portfolios can also be reconciled by a third party appointed by the counterparties. NFCs– are exempt from this obligation.

Portfolio compression

Portfolio compression reduces the number of OTC derivatives transactions outstanding not cleared by a central counterparty in a derivatives portfolio in order to mitigate the risk of counterparty default. If there are fewer than 500 uncleared OTC derivatives transactions outstanding between two counterparties, portfolio compression is not required.

Dispute resolution

No later than the date on which an uncleared OTC derivatives transaction is entered into by a central counterparty, the counterparties must set out in writing the terms governing dispute resolution:

- a) *jurisdiction and governing law;*
- b) *agreement on the procedures for determining, recording and monitoring disputes related to recognition or valuation of the transaction and the exchange of collateral between the counterparties;*
- c) *procedures for rapid dispute resolution and for filing suit on disputes not resolved within five business days.*

Collateral posting

In general, the obligation to post collateral applies to all OTC derivative transactions that are not cleared by a central counterparty (except for currency swaps and forward transactions). NFCs- are exempt from this obligation.

Collateral posting is split into requirements as regards initial margins and variation margins. The daily exchange of variation margins is mandatory for all financial counterparties and for NFCs+.

Counterparties whose gross average position, aggregated at the end of the month, held at group level in OTC derivatives (those that are not cleared centrally, including currency swaps and forward contracts) is greater than CHF8bn for the months of March, April and May of a given year are required to furnish initial margins.

There is no exchange between initial and variation margins when the collateral to be posted is less than CHF500,000.

There is no exchange of initial margins when such margins are less than CHF50m. The various deadlines to be met are stipulated in OFMI Art. 131, para. 4, for variation margins and para. 5 for initial margins.

4.5 Other obligations

Documentation and annual audit

Every counterparty must analyse and document the procedures, processes and internal controls whereby it ensures compliance with the obligations under the FMIA. It is incumbent on the counterparty itself to determine what this documentation should include. However, such documentation must be detailed, consistent and clear enough for an external auditor. The documentation obligation has been in force since January 2016.

Derivatives trading on an FINMA-accredited facility

The FMIA includes an obligation to trade derivatives on a trade platform that is authorised or recognised by FINMA. Participants will have from 6 to 12 months to register with organised trading facilities (OTFs) and/or multilateral trading facilities (MTFs) that have been accredited by FINMA.

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