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FinfraG / EMIR

Current Status – What you need to know

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Agenda

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Background and scope

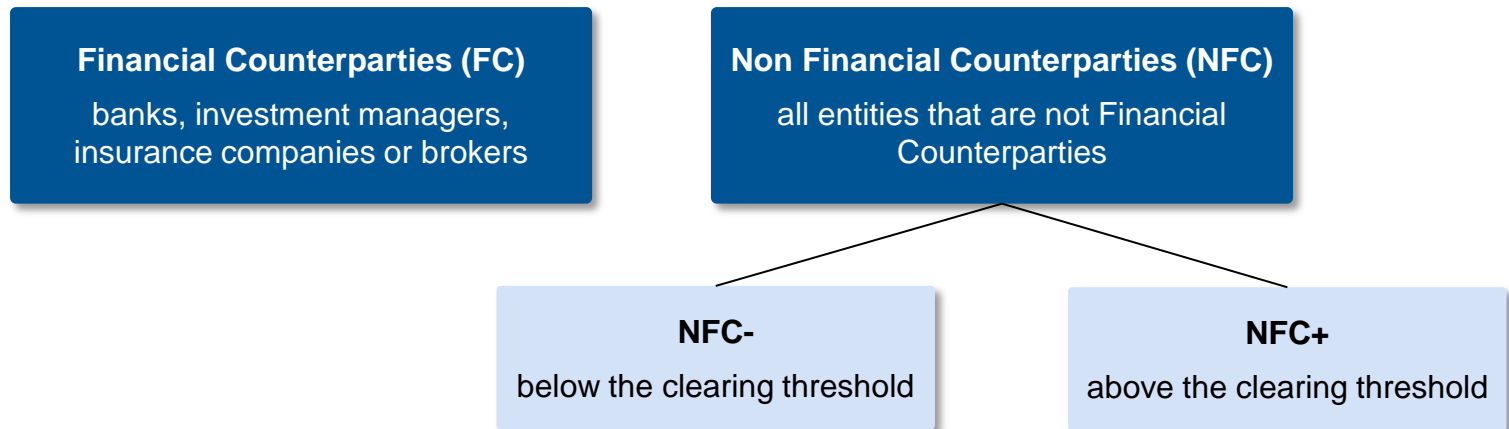
- The financial crisis has brought to light many weaknesses in OTC derivatives markets, such as their intransparency or inherent counterparty risks.
- In reaction to the financial crisis, there has been an international effort to increase stability in financial markets, including OTC derivatives markets: In 2009, G-20 leaders agreed that:



- EMIR (European Markets Infrastructure Regulation) brings in:
 - Clearing obligations
 - Reporting to trade repositories
 - Risk mitigation for non cleared trades
 - Requirements for central counterparties (CCPs) and trade repositories (TRs)

Background and scope

- No matter the type, size or sector, **any business in Europe that undertakes derivative transactions**, including FX forwards, will be impacted by the EMIR.
- EMIR differentiates between two sets of counterparties^{*1}:



- **Products in scope** (based on ESMA consultation paper):
 - Basis Swaps; Fixed-to-float **interest rate swaps** (currencies: EUR, USD, GBP, YEN); Forward rate agreements; Overnight index swaps; European untranched Index **CDS**

^{*1} Detailed EMIR counterparty classification – see Appendix

- International regulation: Dodd-Frank Act Title VII (US); EMIR (EU / EEA); Singapore; Canada; Japan; Australia; Hong Kong; etc. These international regulations have a major impact on market participants world-wide.
- Some regulation is forced on Swiss entities by international regulation, e.g.:
 - EMIR article 4 (1) states that the clearing obligation also applies to contracts „*between two entities established in one or more third countries that would be subject to the clearing obligation if they were established in the Union.*”
- On 3rd September 2014 the Federal Council adopted the dispatch (Botschaft) on Financial Market Infrastructure Act (FMIA)*¹.
- With this new legislation the Federal Council intends to implement the OTC derivatives market reforms set by the G-20 and the Financial Stability Board in 2009.
- In addition, the regulation includes the area of financial market infrastructure such as trading platforms, central settlement offices, securities depositories and trade repositories which need to be adapted to international standards.
- In order to ensure market access to the EU, the FinfraG has to be equivalent to the corresponding EU legislation (EMIR; European Commission requires equivalent third country legal and supervisory frameworks).

*¹ Finanzmarktinfrastukturgesetz (FinfraG)

Main objectives of FinfraG

Competitiveness

- Adoption of regulation to international standards (G-20, FSB, CPSS-IOSCO)

Equivalence

- Creation of an EU equivalent regulation as a prerequisite for the “market access”

Systemic stability

- Safeguarding the stability of systemically relevant FMI (financial market infrastructures)
- Regulation of derivatives trading

Investor protection

- Adaptions of FMI (financial market infrastructures) regulations
- Regulation of derivatives trading

FinfraG	EU Equivalent
<ul style="list-style-type: none"> • Financial market infrastructure (“Finanzmarktinfrastruktur”) <ul style="list-style-type: none"> – Trading venues (Stock Exchanges, Multilateral Trading Facilities (MTFs)) – Post trading infrastructures: Central counterparties “CCPs” (e.g. EUREX, LCH); Central securities depositories (e.g. SIX SIS AG); Trade repositories (e.g. Regis-TR, DTCC, SIX) and Payment systems (e.g. SIC Interbankclearing) 	<p>EMIR / MiFID II / MiFIR / CSDR</p>
<ul style="list-style-type: none"> • Code of market conduct (“Marktverhaltensregeln”) <ul style="list-style-type: none"> – Disclosure of shareholdings*¹ – Public takeovers*¹ – Insider trading and market manipulation*¹ – Derivatives Trading <ul style="list-style-type: none"> ▪ Clearing obligation ▪ Reporting to trade repositories (notification obligation) ▪ Risk mitigation obligation (for non cleared trades) ▪ Platform trading obligation 	<p>MiFID II / MiFIR MiFID II / MiFIR MAR / MAD II</p> <p>EMIR EMIR EMIR MiFIR</p>

*¹ Parts of the “Börsengesetz”, “Bankgesetz” and “Nationalbankgesetz” are repealed and the content is shifted to the FinfraG

Topic		FinfraG	EMIR
Regulation in force		Earliest expected 2 nd half 2015 / early 2016	Since 16.08.2012
Clearing obligation		After FinfraG comes into force in 2015/2016	Phased-in approach: Clearing Members, Non Clearing Members but FC; Non Clearing Members and NFC)* ¹ starting mid 2015
Reporting obligation to trade repositories		After FinfraG comes into force in 2015/2016	All classes (OTCs & ETDs) have to be reported to recognised trade repositories since 14.02.2014
Risk mitigation obligation	<ul style="list-style-type: none"> • Timely confirmation • Daily valuation 	After FinfraG comes into force in 2015/2016	Since 15.03.2014
	<ul style="list-style-type: none"> • Portfolio reconciliation (> 500 daily, > 50 weekly, < 50 quarterly) • Trade compression • Dispute resolution 	After FinfraG comes into force in 2015/2016	Since 15.09.2014
Collateral obligation of bilateral OTC derivatives * ²		Bilateral (non cleared) OTC derivatives have to be collateralised as of 1st December 2015 with variation margin. For the collateralisation of initial margin there will be a volume based phase-in.	

*¹ Pension funds are exempted from central clearing until 15 August 2015 (possibly extendable to August 2018), as well as intra-group transactions, under certain conditions

*² BCBS/IOSCO Standards

Summary of requirements - FinfraG



Requirements		Financial Counterparty	Small Financial Counterparty	Non Financial Counterparty	Small Non Financial Counterparty
Central counterparty clearing obligation		✓	✗	✓	✗
Reporting obligation of derivative transactions to a trade repository		✓	✓	✓	✓
Implementation of basic risk mitigation measures (for non cleared trades)	<ul style="list-style-type: none"> • Timely confirmation • Portfolio reconciliation • Dispute resolution • Portfolio compression 	✓	✓	✓	✓
Extended risk mitigation measures	• Valuation	✓	✗	✓	✗
	• Collateralisation	✓	✓	✓	✗
Platform Trading Obligation		✓	✗	✓	✗

Derivatives trading: Main similarities and differences

Topic	FinfraG	EMIR
Clearing obligation	All jurisdictions require clearing via a central counterparty (CCP for CH and EU)	
	Clearing exemption for Small Financial Counterparty ^{*1} (similar to US)	Small FC does not exist; Clearing exemption for small Non Financial Counterparty (NFC-) (similar in CH)
	FX transactions are out of scope from the clearing obligation (similar to US)	FX transactions are in scope for clearing
Reporting obligation	Both OTC and ETD transactions need to be reported (in US, ETDs do not have to be reported)	
	One-sided reporting obligation and “ cascade ” system to determine the reporting party (similar to US)	Both parties need to report
	“ Beneficial owner ” does not need to be reported (not EMIR but IOSCO compliant)	“Beneficial owner” information is required for the reporting

^{*1} Detailed FinfraG counterparty classification – see Appendix

Derivatives trading: Main similarities and differences

Topic	FinfraG	EMIR
Risk mitigation obligation	The main elements (confirmation timeframe; portfolio reconciliation; dispute resolution; portfolio compression) are the same.	
Group exemption	The group exemption for the clearing obligation will also apply in cross-border situations. Compliance with such exemptions will not be controlled by the regulator but by the auditor.	The group exemption is available only in case the relevant jurisdiction of the other group member has an equivalent regulation and the exemption is approved by an EU regulator.

From the consultation to the dispatch: Overview of the main differences



Note: Only the main differences between the consultation (“Vernehmlassung”) and the dispatch (“Botschaft”) related to derivative transactions are mentioned below

Topic	Main changes
Clearing obligation	FX transactions and forwards only have to fulfill the reporting obligations and are not anymore affected from the clearing and risk mitigation obligations
Definition of derivatives	Repos, securities lending transactions and structured products do not qualify as derivatives and are therefore not affected by FinfraG
Reporting obligation	The notification process for derivative transactions has been simplified in order to avoid duplicate reporting (“cascade” principle)
Compliance with obligations under foreign law	It has been clarified that the derivative trading obligations can be deemed compliant in case they are in compliance with foreign law and such law is recognised by FINMA as equivalent
Definition of Small Financial Counterparty (Small FC)	The qualification as a Small FC is no longer dependent on the volume of derivatives used for the purpose of hedging real estate mortgage risks but depends on the significance of its derivative trading volumes generally
Audit	For Non Financial Counterparties the auditor shall notify the EFD only if the counterparty do not ensure legal conduct

Appendix

- **Financial Counterparties (FC):** Financial Counterparties are defined as counterparties professionally involved in financial markets such as banks, securities dealers, (re-)insurance companies, parent companies of a financial or insurance group, pension funds, investment foundations (Anlagestiftungen), fund management companies and certain other companies licensed under the Collective Investment Schemes Act (CISA).
- **Small Financial Counterparty (Small FC):** Unlike EMIR, the FinfraG introduces a category of Small FCs. The qualification as a Small FC is no longer dependent on the volume of derivatives used for the purpose of hedging real estate mortgages but depends on the significance of its derivative trading volumes generally. Small FCs will be exempted from the clearing obligation.
- **Non Financial Counterparty (NFC):** NFCs are all legal entities that do not qualify as a FC which, e.g. includes asset managers of non-collective investment schemes and investment advisors (other than under EMIR).
- **Small Non Financial Counterparty: Small NFCs** are NFCs that have an average gross position (Durchschnittsbruttoposition) in all relevant categories of OTC derivatives below a certain threshold for a period of 30 consecutive days. Both, the categories of derivatives as well as the thresholds for such categories will be defined by the Federal Council. Positions for the reduction of risk (hedging) are disregarded for the calculation.
- A change of status from FC/NFC to a small FC/NFC will become effective after a four month waiting period. In case a small NFC/FC exceeds the threshold for 30 consecutive days, then it will lose its status as a small NFC/FC.
- The Swiss Federation, cantons, municipalities, the SNB and the Bank for International Settlements **will not be subject to the new rules** on derivatives trading.

EMIR counterparty classification



- A Non Financial Counterparty is classified above the threshold or NFC+, when the rolling average position over 30 working days exceeds the threshold in any non-hedging derivative class.
- A Non Financial Counterparty is classified below the threshold or NFC-, as long as the rolling average position over 30 working days doesn't exceed the thresholds in any derivative classes.

Clearing thresholds by class	
Credit:	€ 1bn
Equity:	€ 1bn
Interest Rates:	€ 3bn
Foreign Exchange:	€ 3bn
Commodities and others	€ 3bn

- **Important:**
 - Hedging transactions do not count for calculations
 - Calculation must cover entire group
 - Intra-group transactions need to be considered
 - Notional value to be considered
 - Effects of the threshold breach:
 - Not only the derivatives class that breaches the threshold comes into clearing but all other derivatives classes as well
 - “Immediate” notification to ESMA and to the national competent authority is required

Abbreviations

- BCBS/IOSCO Basel Committee for Banking Supervision / International Organisation of Securities Commissions
- CCP Central counterparty
- CISA Collective Investment Schemes Act
- CPSS/IOSCO Committee on Payment and Settlement Systems / International Organisation of Securities Commissions
- CSDR EU Central Securities Depository Regulation
- EMIR European market infrastructure regulation (Regulation (EU) No 648/2012)
- ESMA European Securities and Markets Authority
- ETD Exchange traded derivatives
- FinfraG (engl. FMIA) Finanzmarktinfrastukturgesetz (engl. Financial market infrastructure act)
- FSB Financial Stability Board
- MAR Regulation (EU) No 596/2014 on market abuse
- MAD II Directive Market Abuse
- MiFID II Directive 2014/65/EU
- MiFIR Regulation (EU) No 600/2014
- MTF Multilateral Trading Facility
- OTC over-the-counter
- OTF Organized Trading Facility
- SNB Swiss National Bank
- TR Trade repository

This publication has been written in general terms and therefore cannot be relied on to cover specific situations; application of the principles set out will depend upon the particular circumstances involved and we recommend that you obtain professional advice before acting or refraining from acting on any of the contents of this publication. InCube Group AG would be pleased to advise readers on how to apply the principles set out in this publication to their specific circumstances. InCube Group AG accepts no duty of care or liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

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