

Hedging and the ISDA framework

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Most trading houses hedge their price risk on futures exchanges such as the London Metal Exchange, ICE and CME, through over-the-counter swaps with banks or through options. Over-the-counter derivatives are usually documented under the 2002 ISDA Master Agreement of the International Swaps and Derivatives Association, with a Schedule that adapts the standard terms, a Credit Support Annex for collateral and confirmations for each transaction. The Master Agreement is governed by English or New York law and provides for close-out netting on an event of default.¹ Smaller Lugano traders without ISDA documentation hedge through futures accounts with clearing brokers, whose terms impose margin calls that must be met in cash within hours.

Swiss derivatives regulation applies to trading companies as non-financial counterparties. The Financial Market Infrastructure Act of 19 June 2015 (FinMIA) imposes obligations to report derivatives transactions, to apply risk mitigation measures and, above certain thresholds, to clear standardized derivatives through a central counterparty. Small non-financial counterparties, whose rolling average gross positions remain below the clearing thresholds, are subject to lighter obligations. For commodity derivatives the threshold is an average gross position of CHF 3.3 billion.² Hedging transactions that objectively reduce risks directly related to the commercial activity are not counted towards the thresholds. The exemption was designed for the physical commodity trade. A trader that also speculates on its own account may exceed the thresholds and should check its status regularly.

Essentials. A choice of "Swiss law" does not exclude the CISG, which has been in force for Switzerland since 1 March 1991. An express exclusion is needed (Federal Supreme Court, 4A_543/2018 of 28 May 2019). Incoterms 2020 regulate delivery, risk and costs but leave title, payment and remedies to the contract. The GAFTA and FOSFA forms usually prevail over them.

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Letters of indemnity for delivery without bills of lading follow the International Group forms A, B and C under English law and are not covered by P&I insurance. A retention of title in Switzerland requires registration at the buyer's domicile (Art. 715 ZGB).

1 Notes

1. International Swaps and Derivatives Association, 2002 ISDA Master Agreement, Section 5 (events of default and termination events) and Section 6 (early termination and the single close-out amount), as summarized in Wikipedia, "ISDA Master Agreement", https://en.wikipedia.org/wiki/ISDA_Master_Agreement (used as a last resort; also on the Schedule, the Credit Support Annex, confirmations and the English and New York law versions). ↩
2. Federal Act of 19 June 2015 on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading (FinMIA), SR 958.1, Art. 93 para. 3 (non-financial counterparties), Art. 97 ff. (clearing), Art. 98 (small non-financial counterparties), Art. 104 (reporting; no reporting between small non-financial counterparties), Art. 107 ff. (risk mitigation), <https://www.droit-bilingue.ch/en-de/9/95/958.1-98-107.html> and <https://www.droit-bilingue.ch/en-de/9/95/958.1-104-113.html>; Financial Market Infrastructure Ordinance (FinMIO), SR 958.11, Art. 87 (hedging transactions) and Art. 88 (thresholds), <https://www.droit-bilingue.ch/en-de/9/95/958.11-87-105.html> and <https://www.droit-bilingue.ch/en-de/9/95/958.11-88-106.html>. ↩

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