

Hedging, margin and liquidity

*Dr Alexander Ressos, TEP
Attorney-at-Law (Switzerland), Solicitor (Hong Kong),
Solicitor (England & Wales)*

The financing of the physical trade is only one part of a trader's financial needs. The trader hedges its price risk on the futures exchanges, which require margin: an initial margin when the position is opened and variation margin, paid daily, when prices move against the position. The trader must meet the margin requirements in cash, which in volatile markets can reach extraordinary amounts. In 2022, after the Russian invasion of Ukraine, the prices of energy and metals rose so sharply that traders and energy companies across Europe faced margin calls of many billions. Several governments provided emergency liquidity to their energy companies.¹ The episode of the nickel market on the London Metal Exchange in March 2022, when the exchange suspended trading and cancelled transactions after the price had more than doubled within a day, showed how quickly the liquidity of a trader can be threatened by a movement in the market.² For the practitioner, the liquidity risk of a trader has legal consequences. A trader that cannot meet its margin calls may have to close its positions at a loss, may default on its obligations to its clearing broker and may become insolvent within days. The board of a Swiss trading company must monitor its liquidity and take measures when it is threatened, under the revised provisions of company law in force since 2023. The financing documents of the trader must provide the flexibility to draw on its facilities for margin purposes. The relationship between the trader's lenders and its clearing brokers, who hold collateral for the same positions, must also be coordinated.

1 Notes

1. Euronews/Reuters, "Explainer – How margin calls came to threaten Europe's energy firms", 17 September 2022, euronews.com: Equinor estimated that European companies needed at least EUR 1.5 trillion to cover their exposure; Uniper bailout of EUR 15 billion, since grown to EUR 19 billion; government guarantees for Fortum (Finland) and Axpo

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(Switzerland). S&P Global, "Swiss government approves CHF 4 billion credit line for Axpo", 6 September 2022, spglobal.com: state-backed credit facility to meet collateral requirements; comparable support measures in Finland, Sweden, Germany, France, Spain and the Czech Republic. ↩

2. Lewis Silkin, "Court backs decisions regarding cancellation of nickel trades", 6 February 2024, lewissilkin.com: trading suspended on 8 March 2022 at 08:15; trades of that day prior to suspension, worth about USD 12 billion, cancelled; the three-month nickel price more than doubled on 8 March 2022; R (Elliott Associates LP and others) v The London Metal Exchange and LME Clear Ltd [2023] EWHC 2969 (Admin). ↩

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