

Derivatives

We welcome the many infrastructure developments in the Russian derivatives markets over the past five years and believe the launch of the MIFC has provided focus and a development plan to grow the embryonic markets in an organised manner.

Recent changes to Article 1062 of the State Duma clarified that trading in derivatives is not gaming, defined the range of permitted products and recognised the efficacy of master agreements subject to registration at an approved trade repository. The introduction of such a repository and a hoped for clean legal opinion as to the enforceability of the [ISDA] over derivatives transactions under Russian law and ISDA under various legal jurisdictions including the Laws of England and Wales will complete the regulatory and legal framework.

These foundations will support the development of a deep and liquid derivatives market and enable companies and banks to hedge and trade their exposures in a well regulated, secure environment. It will also allow for greater certainty as trades are matched and provide improved risk management to banks, their clients, regulators and supervisors alike.

We recognise the progress made on the above points. We also welcome the effective appointment of NSD as the trade repository for derivatives. NSD has defined an ambitious project plan for the operational implementation of such trade-repository by the end of 2012. Even though the timeline is ambitious, we welcome it as the introduction of Basel 3 at the start of 2013 will require off-shore and domestic banks to apply a new regulatory risk capital charge, known as a Counterparty Valuation Adjustment (CVA), when dealing with international and Russian counterparties. In the absence of a clean legal opinion as to the enforceability of master agreements, itself dependent on the introduction of a functioning trade repository, 'close out netting' will not be enforceable and large regulatory capital charges will be applied to derivative and other OTC transactions which will act as drag on the development of deep, secure liquid market. It could potentially lead to a schism in the market off-shore and domestic markets which is not welcomed given that the two are symbiotic.

The task of developing a trade repository across a wide range of OTC and exchange traded products is complex and, in the west, where few exist, it has taken time. The detail surrounding transaction matching and attendant messaging, to and from participants and the regulators, is critical and could derail the timing of the project.

Beyond the above mentioned steps being undertaken we would advise you that further reform is necessary. In particular the recognition and effectiveness of collateral in bankruptcy is essential. The use of collateral is crucial as banks minimize unsecured exposure to their counterparties and as regulators enforce and encourage its use, the introduction of Basel 3 will force a higher CVA charge on uncollateralized derivatives.

We would also recommend further work on the proper 'equipment' of the judiciary in order to be able to deal with the application of the law.

Recommendations:

1. Launch the trade repository as soon as possible if need be on a staged approach starting with OTC products evidenced by master agreements.
2. Given the tight timeframes, and the need for close-out netting to be effective before the launch of Basel 3 it is essential for foreign banks located offshore or in Russia to be able to work with a messaging format (such as SWIFT) they are familiar with.
3. Effectiveness of collateral agreements in bankruptcy needs to be ensured.
4. The judiciary needs to be properly equipped to be able to deal with the complexities involved in the dispute resolution surrounding derivatives.

We are now engaged with many market experts in Moscow, support the choice of NSD as the proposed trade repository and offer the continuing full support of our members across the range of disciplines including law, accounting, trading, clearing, collateral and risk management. As we develop our markets in Western Europe we are keen to maintain this dialogue as you in Russia develop yours. This has been a good start.

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