



Bank of Russia

The Central Bank of the Russian Federation



July 2016

Consultation Paper

**ON MANDATORY
CLEARING OF
STANDARDISED OTC
DERIVATIVES**

MOSCOW

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Abbreviations

- BCBS — Basel Committee on Banking Supervision
- BIS — Bank for International Settlements
- ICMA — International Capital Market Association
- CPSS-IOSCO — International Organisation of Securities Commissions
- ISDA — International Swaps and Derivatives Association
- FSB — Financial Stability Board
- G20 — The Group of Twenty
- CFTC — U.S. Commodity Futures Trading Commission
- ESMA — European Securities and Markets Authority
- HKMA — Hong Kong Monetary Authority
- MAS — Monetary Authority of Singapore
- SFC — Securities and Futures Commission
- EMIR — European Market Infrastructure Regulation No. 648/2012, dated July 4th 2012, on over-the counter (OTC) derivatives, central counterparties, and trade repositories
- RTS — Regulatory Technical Standard
- Dodd-Frank Act — Dodd-Frank Wall Street Reform and Consumer Protection Act
- FX Forward — Forex forward
- FX Swap — Forex swap
- IRS — Interest rate swap
- OIS — Overnight index swap
- CDS — Credit default swap
- RUB — Russian rouble
- USD — US dollar
- EUR — Euro
- HKD — Hong Kong dollar
- JPY — Japanese yen
- CC — Central counterparty
- NCC — Bank National Clearing Centre JSC
- IFRS — International Financial Reporting Standards
- CC RF — The Civil Code of the Russian Federation
- TC RF — The Tax Code of the Russian Federation
- Law on Banks — Federal Law No. 395-1, dated December 2nd 1990, 'On Banks and Banking Activities'
- Law on the Bank of Russia — Federal Law No. 86-FZ, dated July 10th 2002, 'On the Central Bank of the Russian Federation (Bank of Russia)'
- Law on Clearing — Federal Law No. 7-FZ, dated February 7th 2011, 'On Clearing, Clearing Activities, and the Central Counterparty'
- Law on the Securities Market — Federal Law No. 39-FZ, dated April 22nd 1996, 'On the Securities Market'
- Law on Organised Trading — Federal Law No. 325-FZ, dated November 21st 2011, 'On Organised Trading'
- Ordinance on Reporting to Trade Repository — the Bank of Russia Ordinance No. 3253-U dated April 30th 2014 'On the Procedure for Keeping the Register of the Agreements Made under the Terms of a Master Agreement (Single Contract), Information Delivery Deadlines Needed for Keeping the Specified Register and Information from the Specified Register and Delivery of the Register of the Agreements Made under the Terms of a Master Agreement (Single Contract) to the Central Bank of the Russian Federation (Bank of Russia)'

INTRODUCTION

In response to the challenges brought by the financial crisis of 2008, the G20 leaders have reached an agreement regarding the main areas for reforming the OTC derivatives market in order to enhance the financial market stability¹. It was decided that:

- Standardised OTC derivatives should be subject to central clearing.
- OTC derivatives should be reported to trade repositories.
- Standardised OTC derivatives should be traded on exchanges or electronic trading platforms².
- Non-centrally cleared OTC derivatives should be subject to higher capital requirements.
- Non-centrally cleared OTC derivatives should be properly collateralized.

According to the information presented in the FSB Report³ as of end of September 2015, the requirement for mandatory central clearing came into effect in 5 jurisdictions (China, India, Japan, Korea, and the United States), and similar requirements are to come into force also in Australia and the EU in 2016.

The purpose of this consultation paper is to present for broad public discussion with financial market participants the approaches to implementing the obligations assumed by Russia within the framework of the G20 in terms of phasing in the requirement for mandatory central clearing of standardised OTC derivatives.

The approaches presented for public consultation are based on the results of the research on the current state of the Russian derivatives market and the relevant experience of the USA, the European Union, and Asia (Singapore, Hong Kong), taking into account the recommendations and standards developed by IOSCO and ISDA.

The proposed approaches were preliminary considered by the Derivatives Board (DB)⁴.

Financial Market Development Department of the Bank of Russia would expect comments on this consultation paper, including answers to the questions raised as well as other suggestions, to be submitted to the following address (e-mail): svc_derivatives@cbr.ru until September 15th 2016.

In addition, the Bank of Russia plans to organize a number of on-site consultations with the representatives of the professional community, inter alia, during the upcoming conferences and fora.

Following the consultations, the Bank of Russia will release the summary of the received comments and suggestions and disclose its final approaches to the introduction of mandatory central clearing of standardised OTC derivatives.

¹Leaders' Statement, The Pittsburgh Summit, September 24-25, 2009, https://g20.org/wp-content/uploads/2014/12/Pittsburgh_Declaration_0.pdf; Leaders' Statement, The Cannes Summit, Cannes November 4, 2011, <http://www.g20.utoronto.ca/2011/2011-cannes-declaration-111104-en.html>.

²In cases where the use of an electronic trading platform is applicable.

³OTC Derivatives Market Reforms, Tenth Progress Report on Implementation, Financial Stability Board, November 2015. <http://www.fsb.org/wp-content/uploads/OTC-Derivatives-10th-Progress-Report.pdf>.

⁴DB was established to elaborate the derivatives market development strategy upon the initiative of three associations – The Association of Russian Banks (ARB), Russian National Association of Securities Market Participants (NAUFOR), and National Securities Market Association (NSMA). The additional information is available at <http://www.spfi.info>.

KEY PROPOSALS

This consultation paper contains the following proposals of the Bank of Russia on approaches to implementing the decisions adopted by the G20 on submitting standardised OTC derivatives for central clearing:

1. To introduce a requirement for mandatory central clearing (with due regard to economic incentives for using a clearing system to the participation of a CCP in comparison with the traditional system of bilateral transactions).

2. To phase in the requirement for mandatory central clearing on the basis of the categories of standardised OTC derivatives and financial market participants, who deal with trading of such derivatives.

3. At the first stage (which should begin not earlier than 2017) to restrict the list of standardised OTC derivatives subject to central clearing to the following interest rate swaps (IRSs):

- Overnight index swap denominated in RUB, USD, EUR for a period from 1 week to 1 year.
- Basis swap denominated in RUB, USD, EUR for a period from 1 week to 5 years.
- Fixed-to-floating swap denominated in RUB, USD, EUR for a period from 1 week to 5 years.
- At the second stage (which should begin not earlier than 2018) the requirement shall also apply to the following FX derivatives:
 - FX Forward denominated in RUB, USD, EUR for a period from 1 week to 5 years.
 - FX Swap denominated in RUB, USD, EUR for a period from 1 week to 5 years.

4. To apply mandatory central clearing at the first stage only to standardised OTC derivatives traded between credit institutions and professional securities market participants licensed for dealer and/or brokerage activities and/or securities management, as well as organisations licensed as a management company for one of the following types of funds: investment fund, unit investment fund, or non-governmental pension fund.

5. At the second stage to establish a threshold value for the aggregate nominal value on each category of derivatives in the amount of 10 billion roubles as of end of quarter for three consecutive quarters for the participants of the OTC derivatives market other than the entities indicated in paragraph iii.

6. Not to apply the mandatory central clearing requirement to intra-group derivatives and derivatives with certain entities.

7. To establish the possibility of using both the legal device stipulated by Part 12, Article 4 of the Law on Clearing (novation) and an open-offer for the purposes of submitting standardised OTC derivatives for central clearing.

8. To establish the obligation to submit a transaction for central clearing not later than the initial transaction date ('T0') when using the mechanism stipulated by Part 12, Article 4 of the Law on Clearing (novation), which implies the conclusion of an initial transaction between the parties.

9. To establish the approach according to which the information on standardised OTC derivatives submitted to central clearing shall be reported to the trade repository only by the CCP.

SECTION I. CENTRAL CLEARING OF STANDARDISED OTC DERIVATIVES

1. The proposals set forth in this consultation paper are based on the results of the research on the advanced international practices and aim at creating an appropriate regulatory environment ensuring the predominance of the economic incentives over the administrative ones in terms of submitting standardized OTC derivatives for central clearing.

2. Among the most important reasons justifying the economic viability of clearing with a CCP as compared to the traditional system of bilateral transactions the foreign regulators outline the following ones⁵:

- Systemic risk reduction in the financial market as a result of the reduction in numbers of bilateral transactions between major participants of the financial market (avoiding 'domino effect').

- Credit risk reduction for market participants because of its redistribution to the CCP, which meets higher requirements to its risk management system.

- Increased netting efficiency due to increased number of participants involved and the use of clearing, which, in turn, should minimize the amount of required collateral and, as a consequence, reduce the costs and facilitate market liquidity.

- More effective risk and collateral management through the use of standardised mechanisms, taking into account the prospective adoption of man-

datory margining of OTC derivatives.

3. Taking into consideration the specifics of the Russian banking regulation, the following impact of central clearing on the calculation of statutory ratios can be distinguished:

- A reduction of pressure on the capital of the banks entering into OTC derivatives transactions, since the OTC derivatives cleared with CCP are not included in calculations of the risk of change in credit claim value as a result of the deterioration of the counterparty's credit quality.

- A possible increase in the liquidity coverage ratio due to the fact that the submission of standardised OTC derivatives for central clearing should allow credit institutions to include the aforementioned derivatives in the net outflow (inflow) value when calculating the index of short-term liquidity and the corresponding statutory ratio (subject to a number of restrictions).

4. With the adoption of the requirement for central clearing, the role and the importance of the quality of the CCP's risk management system increases.

5. To date, taking into account the amendments made to the Law on Clearing by Federal Law No. 403-FZ, dated December 29th 2015, 'On Amending Certain Laws of the Russian Federation,' a statutory framework was created which provides for ensuring the proper functioning of a CCP in line with the international principles, primarily those referred to its risk management system.

⁵See, for example: Market Practice and Regulatory Policy, ICMA. <http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/frequently-asked-questions-on-repo/27-what-does-a-ccp-do-what-are-the-pros-and-cons/>; The Role of Central Counterparties, European Central Bank. <https://www.ecb.europa.eu/pub/pdf/other/rolecentralcounterparties200707en.pdf?734973e95c26ba824f205887f53c819c>.

⁶Clause 2 of Annex 8 to the Bank of Russia Instruction No. 139-I, dated December 3rd 2012, 'On Banks' Statutory Ratios.'

⁷Clauses 3.5.2 and 4.8 of the Bank of Russia Regulation No. 421-P, dated December 3rd 2015, 'On Calculation of the Liquidity Coverage Ratio ('Basel III').'

⁸Principles for financial market infrastructure, CPSS-IOSCO, 2012 <http://www.bis.org/cpmi/publ/d101a.pdf>.

Questions for Section I

1. Do you have any comments/suggestions regarding the abovementioned economic incentives for the submission of transactions for clearing to a CCP or the possibility of their implementation? If you do, please provide specific details.

2. Do you have any comments/suggestions as to existing or potential barriers that complicate the submission of OTC derivatives for central clearing and, if there are any, as to how they can be remedied? If you do, please provide specific details.

I.1. OTC Derivatives Subject to Mandatory Central Clearing

6. According to the recommendations of IOSCO⁹, the approach used by regulators in determining individual derivatives classes/types for the purposes of imposing a requirement for mandatory central clearing of such transactions can be based on the following principles:

- The 'bottom-up' principle (the regulator adopts the list of derivatives that are already accepted for clearing by an authorised or recognised CCP).

- The 'top-down' principle (the regulator independently determines the list of derivatives that are subject to mandatory central clearing, while there are no CCPs authorised to clear such derivatives).

7. The Bank of Russia is considering the possibility of establishing the primary list of instruments that are subject to mandatory central clearing on the basis of the 'bottom-up' principle.

8. In choosing this principle as the basis for the purpose of determining the categories of derivatives subject to central clearing, the Bank of Russia established the criteria set forth in the FSB report 'Implementing OTC Derivatives Market Reforms'¹⁰

⁹Requirements for Mandatory Clearing, IOSCO, February 2012 <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD374.pdf>.

¹⁰Recommendation 5, FSB's report Implementing OTC derivatives market reforms, 2010, <http://www.fsb.org/2010/10/fsb-report-on-implementing-otc-derivatives-market-reforms>.

with regard to the involvement of a CCP that clears this category of OTC derivatives and the CCP's ability to process the anticipated number of transactions and to manage the risks arising as a result of clearing of the corresponding category of OTC derivatives.

9. NCC, as the national systemically important CCP¹¹, currently accepts interest rate and FX derivatives for central clearing¹².

10. In order to avoid regulatory arbitrage, when implementing the stated principle, the Bank of Russia deems it necessary to synchronise the stages of central clearing implementation with other jurisdictions, inter alia in terms of the categories of instruments.

11. In the international practice¹³, as a rule, the derivatives that are subject to central clearing at the first stage are interest rate derivatives. Moreover, in some jurisdictions at the first stages it is suggested that clearing should be implemented with regard to certain credit derivatives, in particular CDS. Using the example of certain jurisdictions Table 1 shows information on derivatives which are already subject to mandatory central clearing or should be so before the end of 2017.

¹¹Based on the analysis of the activities of all financial market infrastructure organisations operating in Russia, the Bank of Russia has recognised NCC as a national systemically important central counterparty under the Bank of Russia Ordinance No. 3341-U, dated July 25th 2014, 'On Recognising Financial Market Infrastructures as Systemically Important.' Information on financial market infrastructure organisations, which are recognised by the Bank of Russia as systemically important, is published on the official site of Bank of Russia at the address:

[http://www.cbr.ru/analytics/default.aspx?](http://www.cbr.ru/analytics/default.aspx?Prtid=fin_stab&ch=ITM_6542#CheckedItem)

[Prtid=fin_stab&ch=ITM_6542#CheckedItem.](http://www.cbr.ru/analytics/default.aspx?Prtid=fin_stab&ch=ITM_6542#CheckedItem)

¹²Information is presented on the official site of NCC at the address:

[http://www.nkcbank.ru/viewCatalog.do?menuKey=275.](http://www.nkcbank.ru/viewCatalog.do?menuKey=275)

¹³Principles See, for example: <https://www.esma.europa.eu/sites/default/files/library/>

[public_register_for_the_clearing_obligation_under_emir.pdf,](https://www.esma.europa.eu/sites/default/files/library/public_register_for_the_clearing_obligation_under_emir.pdf)

[http://www.cftc.gov/idc/groups/public/@newsroom/documents/](http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister112812.pdf)

[file/federalregister112812.pdf,](http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister112812.pdf) [http://www.hkma.gov.hk/media/eng/doc/key-information/press-](http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2015/20150930e7a1.pdf)

[release/2015/20150930e7a1.pdf.](http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2015/20150930e7a1.pdf)

Table 1

International practice

EMIR* (EU)		Dodd-Frank Act** (USA)		Consultation paper*** (Hong Kong)
Interest rate derivatives (IR)	Credit derivatives (CD)	Interest rate derivatives (IR)	Credit derivatives (CD)	Interest rate derivatives (IR)
Basis swap (EUR, GBR, JPY, USD) (begins from June 21 st 2016)	Index CDS (begins from February 9 th 2017)	Basis swap (EUR, GBR, JPY, USD) (begins from September 9 th 2013)	Index CDS	Basis swap (HKD, EUR, GBR, JPY, USD) (begins from July 1 st 2017)
Fixed-to-float swap (EUR, GBR, JPY, USD) (begins from June 21 st 2016)		Fixed-to-float swap (EUR, GBR, JPY, USD) (begins from September 9 th 2013)		Fixed-to-float swap (HKD, EUR, GBR, JPY, USD) (begins from July 1 st 2017)
Forward rate agreement (EUR, GBR, USD) (begins from June 21 st 2016)		Forward rate agreement (EUR, GBR, USD) (begins from September 9 th 2013)		
OIS (EUR, GBR, USD) (begins from June 21 st 2016)		OIS (EUR, GBR, USD) (begins from September 9 th 2013)		OIS (EUR, GBR, JPY, USD) (begins from July 1 st 2017)

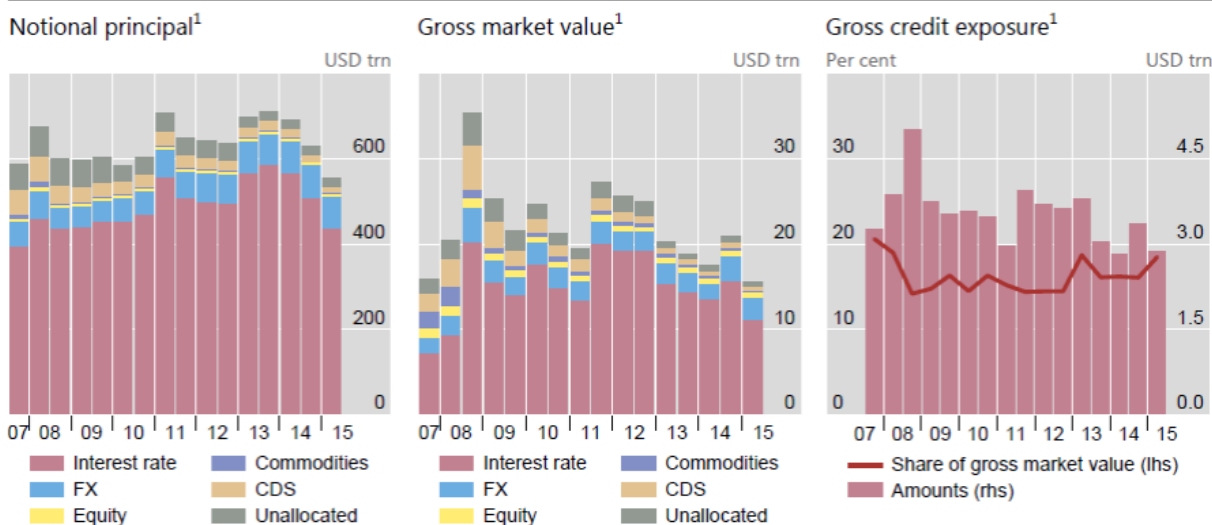
*The information has been published on the official site of ESMA at the address: <https://www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation>.

**The information has been published on the official site of CFTC at the address: <http://www.cftc.gov/ucm/groups/public/@otherif/documents/ifdocs/clearingrequirementcharts.pdf>.

***Consultations and further consultation on introducing mandatory clearing and expanding mandatory reporting, the HKMA, SFC, 2016. [http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2016/Consultation Conclusions eng.pdf](http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2016/Consultation%20Conclusions%20eng.pdf).

Global OTC derivatives markets

Graph 1*



Further information on the BIS derivatives statistics is available at www.bis.org/statistics/derstats.htm.

¹ At half-year end (end-June and end-December). Amounts denominated in currencies other than the US dollar are converted to US dollars at the exchange rate prevailing on the reference date.

*The graphs have been published in the statistical release of the Bank of International Settlements (BIS) on OTC derivatives as of the first quarter of 2015. Statistical release 'OTC derivatives statistics at end-June 2015,' Monetary and Economic Department, BIS, November 2015. http://www.bis.org/publ/otc_hy1511.pdf. More detailed statistical information on OTC derivatives is available on the official BIS site at the address: <http://www.bis.org/statistics/derstats.htm>.

12. This approach is due, among other things, to the fact that interest rate derivatives are the most popular in the international financial market

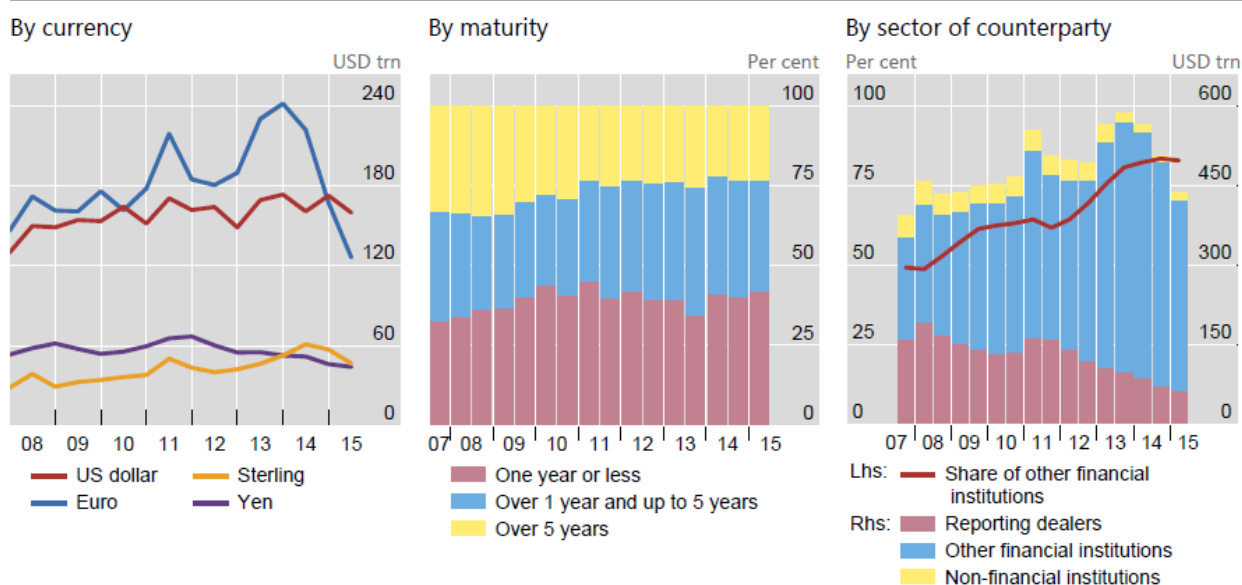
Graph 1).

13. The data derived from the trade repository reports indicates that the Russian interest rate de-

OTC interest rate derivatives

Notional principal¹

Graph 2



Further information on the BIS derivatives statistics is available at www.bis.org/statistics/derstats.htm.

¹ At half-year end (end-June and end-December). Amounts denominated in currencies other than the US dollar are converted to US dollars at the exchange rate prevailing on the reference date.

derivative market is still evolving. However, the aforementioned instruments are of potential interest to both credit institutions and other participants of the financial market; in comparison to other derivatives, interest rate derivatives require little capital coverage of risks related to them.

14. Considering the insufficiency of active financial market participants and the participants' heterogeneity with regard to credit quality, the Bank of Russia presumes that the concentration of OTC interest rate derivatives at a CCP with a high level

of creditworthiness and a certain degree of standardisation of traded instruments it accepts for clearing will make it possible to increase the liquidity of the corresponding financial market segment.

15. Taking into account the aforementioned approaches, the international experience in implementing the requirement for mandatory central clearing, and the specifics of the Russian interest rate derivatives market it is suggested that at first the Bank of Russia by its regulation should establish a list of certain interest rate swaps (IRS), which

Table 2

Basis swap

No.	Foreign currency	Floating interest rate	Term	Constant notional amount
1	RUB	MOSPRIME	1 week to 5 years	Yes
2	USD	LIBOR	1 week to 5 years	Yes
3	EUR	EURIBOR	1 week to 5 years	Yes

Table 3

Fixed-to-floating swap

No.	Foreign currency	Floating interest rate	Term	Constant notional amount
1	RUB	MOSPRIME	1 week to 5 years	Yes
2	USD	LIBOR	1 week to 5 years	Yes
3	EUR	EURIBOR	1 week to 5 years	Yes

Table 4

Overnight index swap

No.	Foreign currency	Floating interest rate	Term	Constant notional amount
1	RUB	RUONIA	1 week to 5 years	Yes
2	USD	USFEDFUNDS	1 week to 5 years	Yes
3	EUR	EONIA	1 week to 5 years	Yes

shall be subject to central clearing. It is planned to apply the requirement for mandatory central clearing only to standardised derivatives traded under the terms and conditions of either a master agreement (single contract) or a separate agreement that is not a part of a mixed agreement (for example, a loan agreement where an IRS is an integral part of it).

16. For the purposes of this consultation paper, 'IRS' means the OTC derivatives according to the terms and conditions of which:

a) The parties have agreed to make periodical and/or one-time payments to each other depending on the change in an interest rate.

b) The amounts in cash due shall be calculated in accordance with:

- A single notional amount.
- Floating interest rates or fixed and floating interest rates agreed upon by the parties.

17. It is suggested that the following swaps be included in the list of IRSs:

a) Basis swap corresponding to the specifications stipulated in Table 2. For the purposes of this consultation paper, 'basis swap' means an IRS according to the terms and conditions of which:

– The first party calculates the amount in cash payable to the second party based on the notional amount and a floating interest rate.

– The second party calculates the amount in cash payable to the first party in the same currency based on the notional amount and another floating interest rate.

b) Fixed-to-floating swap corresponding to the specifications stipulated in Table 3. For the purposes of this consultation paper, 'fixed-to-floating swap' means an IRS according to terms and condi-

tions of which:

– The first party calculates the amount in cash payable to the second party based on the notional amount and a fixed interest rate.

– The second party calculates the amount in cash payable to the second party based on the notional amount and a floating interest rate.

c) Overnight index swap corresponding to the specifications stipulated in Table 4. For the purposes of this consultation paper, 'overnight index swap' means a fixed-to-floating swap for which the floating interest rate is calculated on the basis of the overnight interest rate index.

18. Taking into account the international practice and IOSCO¹⁸ recommendations, the Bank of Russia suggests establishing a requirement for mandatory central clearing only for transactions that have been concluded after:

a) The requirement for mandatory central clearing for such transactions has come into effect, or

b) The threshold value of such transactions has been exceeded after the requirement for mandatory central clearing has come into effect (for transactions one of the parties to which is a participant belonging to Category 2).

19. As the mechanism of central clearing and the improvement of CCP technological systems progress, the range of instruments subject to mandatory central clearing should expand. The next category of derivatives to which the requirement for mandatory central clearing will apply is the category of FX derivatives, in particular, FX Forwards, FX Swaps.

¹⁸Principles for financial market infrastructure, CPSS-IOSCO, 2012. <http://www.bis.org/cpmi/publ/d101a.pdf>.

Questions for Section I.1

3. Do you have any comments/suggestions as to the phasing in of the requirement for mandatory central clearing of standardised OTC derivatives? If you do, please provide specific details.

4. Do you have any comments/suggestions as to the derivatives to which the requirement for mandatory central clearing should first be applied? If you do, please provide specific details.

5. Do you have any comments/suggestions as to the choice of the list of currencies in which derivatives are denominated and as to the floating interest rates and terms set forth in Tables 2–4? If you do, please provide specific details.

6. Do you have any comments/suggestions as to the further expansion of the list of instruments subject to the requirement for mandatory central clearing to include certain FX derivatives (FX Forwards, FX Swaps)? If you do, please provide specific details.

7. Do you think it is appropriate to apply the requirement for mandatory central clearing to other derivatives not indicated in this Section of the consultation paper, for example, to cross-currency interest rate swaps or options?

I.2. Categories of the OTC Derivatives Market Participants Subject to the Requirement for Mandatory Central Clearing

I.2.1. Classification of OTC Derivatives Market Participants According to their Capacity

20. The analysis of the experience of implementing a requirement for mandatory central clearing of standardised OTC derivatives in foreign legal systems confirms the viability of phasing in introduction of the aforementioned requirement de-

pending, inter alia, on the category of the OTC derivatives market participants. A similar approach is proposed by the Bank of Russia.

21. It is proposed that the participation volume of each category in the Russian OTC derivatives market should be established as the main criteria of classification:

- Category 1: credit institutions and professional participants of the securities market that are licensed for dealer and/or brokerage activities and/or securities management, as well as organisations that are licensed as a management company for one of the following types of funds: investment fund, unit investment fund and non-governmental pension fund.

- Category 2: other participants of the OTC derivatives market. These are entities trading standardised derivatives on the OTC market and not belonging to Category 1.

I.2.2. Additional Criteria of Classification Depending on the Volume of Traded OTC Derivatives

22. For the financial market participants belonging to Category 2, the Bank of Russia is considering the possibility of introducing a requirement for mandatory central clearing only if such participants have reached the threshold amount, which is the aggregate notional value of open positions on each derivatives category¹⁹ (hereinafter referred to as the 'Threshold Value') established by the Bank of Russia.

23. The amount of 10 billion roubles as of end of quarter during three consecutive quarters is proposed as the Threshold Value for each derivatives category. When the Threshold Value has been reached, newly concluded (from the first day of the

¹⁹ Clause For the purposes of this consultation paper, eligible derivatives (categories of derivatives) mean at the initial stage:

- interest rate derivatives (certain derivatives included in this class are listed in Table 5);
- FX derivatives (certain derivatives included in this class are listed in Table 5).

The classification of participants of the OTC derivative market for phasing in the requirement of mandatory central clearing

Table 5

Stage	Derivative classification by category of parties		Interest rate derivatives		FX derivatives	
	Party 1	Party 2	Overnight index swap	Basis swap, Fixed-to-floating swap	Forex Forward	Forex Swap
1 stage	Category 1	Category 1	3 months after the Bank of Russia's regulation takes effect	6 months after the Bank of Russia's regulation takes effect	12 months after the Bank of Russia's regulation takes effect	15 months after the Bank of Russia's regulation takes effect
2 stage	Category 1	Category 2	2 years after the Bank of Russia's regulation takes effect	2 years after the Bank of Russia's regulation takes effect	3 years after the Bank of Russia's regulation takes effect	3 years after the Bank of Russia's regulation takes effect
	Category 2	Category 2				

**The table is based on the assumption that each party to a transaction has exceeded the Threshold Value (where applicable), and the transaction is not exempted from the requirement for mandatory centralised clearing of OTC derivatives stipulated in Section I.3. of this consultation paper.*

***The Bank of Russia's regulation on mandatory central clearing of standardised OTC derivatives is expected to take effect not earlier than January 1st 2017.*

months following the latest of the three quarters when the Threshold Value was reached) OTC derivatives, to which the participant that has reached the Threshold Value is a party, shall be submitted for central clearing.

24. If the financial market participant, after exceeding the Threshold Value for eight consecutive quarters, does not exceed the corresponding Threshold Value (as of end of each quarter), the requirement for mandatory central clearing does not apply to the OTC derivatives of respective category traded from the first day of the month following the latest of the eight quarters.

25. The proposed approach assumes that each party to the transaction has reliable information on the counterparty's category and on the exceedance/non-exceedance of the Threshold Value by the counterparty for the purposes of making the decision on transfer of the OTC transaction to central clearing.

26. One should consider an optimal mechanism for obtaining the aforementioned information by the parties. It is proposed that such mechanism should be built on the use of the standard notification forms developed by a special self-regulated financial association, which will be exchanged at the moment the transaction is executed, allowing the parties to receive such information in a timely fashion.

ion. An example of the implementation of such approach is the EMIR Classification Letter developed by ISDA²⁰.

27. The stages of the phasing in of the requirement for mandatory central clearing of OTC derivatives proposed by the Bank of Russia, depending on the derivative category, and the participant category with due regard to the Threshold Value are set forth in Table 5.

28. For the purposes of applying the requirement for mandatory central clearing to standardised OTC derivatives, the precursory criteria is the existence of a systemically important national CCP that accepts the OTC derivatives in question for clearing.

²⁰ EMIR Classification Letter, ISDA, July 13th 2015. <https://assets.isda.org/media/1bbeae9d-2/c222ed2b.doc>.

Questions for Section I.2

8. Do you have any comments/suggestions regarding the classification of participants of the OTC derivative market for phasing in the requirement of mandatory central clearing of standardised OTC derivatives? If you do, please provide specific details.

9. Do you have any comments/suggestions regarding the Threshold Value for the purposes of implementing the requirement for mandatory central clearing of standardised OTC derivatives? If you do, please provide specific details.

10. Do you have any comments/suggestions regarding the terms for phasing in the requirement for mandatory central clearing of standardised OTC derivatives depending on participant and derivatives category? If you do, please provide specific details.

11. Do you have any suggestions on applying the requirement for mandatory central clearing to standardised OTC derivatives entered into by an entity, which is a foreign resident?

12. Do you consider it reasonable to secure the recognition of a Russian CCP by a foreign state as a condition for mandatory central clearing of derivatives, where one party is an entity which is a resident of the foreign state in question? Do you think the condition should be expanded to include the requirement of simultaneous recognition of a CCP of the foreign state in question by the Russian Federation?

I.3. Exceptions from the General Requirement for Mandatory Central Clearing of OTC Derivatives

29. The Bank of Russia is considering the following exceptions from the general requirement of mandatory central clearing of OTC derivatives:

- Intra-Group Derivatives
- Derivatives with certain entities

I.3.1. Intra-Group Derivatives

30. The proposed exception is based on the fact that the risks associated with executing an Intra-Group Derivative arise centrally within one group, allowing parties to such derivative transaction to organise appropriate management of such risks.

31. Most jurisdictions find it reasonable to exclude intra-group transactions from the general requirement for mandatory central clearing.

32. In the Russian legal framework it is proposed, for the application of the exception based on the 'Intra-Group Derivatives' criterion, that all of the following conditions should be met simultaneously:

a) Parties to a derivative should fall in the same 'group' as this term defined for the purposes of central clearing. We assume that categories such as 'group of entities' and 'affiliates' defined in RSFSR Law No. 948-1, dated March 22nd 1991, 'On Competition and the Limitation of Monopolistic Activity on the Commodities Market' are not applicable to the legal relationships at issue. Therefore, the definition of the term 'control' stipulated in IFRS 10, Consolidated Financial Statements,²¹ is proposed for consideration as a criterion for determining a 'group' for the abovementioned purpose.

b) The activities of the parties to a derivative presuppose that IFRS financial statements are consolidated completely²¹.

c) Parties to a derivative have a common (centralised): risk management system, including in terms of risk identification, assessment, record-keeping, and monitoring; and the organisation of the system of quality control and assessment at all

²¹ EMIR In accordance with clause 2 of International Financial Reporting Standards (IFRS) 10, 'Consolidated Financial Statements' (enacted in the Russian Federation by Order No. 217n of the Ministry of Finance of the Russian Federation, dated December 28th 2015).

stages of risk management, which every group member uses as a basis for creating such risk management systems individually.

d) Before entering into a derivative, which is subject to central clearing, the parties have given the Bank of Russia a notice of application of the exception for Intra-Group Derivatives in the form established by the Bank of Russia.

I.3.2. Derivatives with Certain Entities

33. This category is proposed to include derivatives with the Bank of Russia.

Questions for Section I.3

13. Do you have any comments/suggestions regarding the exception from the general requirement of mandatory central clearing of Intra-Group Derivatives? If you do, please provide specific details.

14. Do you have any comments/suggestions regarding the proposed conditions for classification of a derivative as an Intra-Group Derivative? In particular, are the requirements for a common (centralised) risk management system aligned with the existing business models?

15. Do you have any proposals regarding extension of the list of exemptions from the requirement for mandatory central clearing? In particular, is it necessary to exclude the derivatives made for the purpose of hedging from the requirement for mandatory central clearing? If you do, please provide specific details.

I.4. The Mechanism of Submission of Standardised OTC Derivatives for Central Clearing

34. To appropriately implement the requirement for mandatory central clearing of standardised OTC derivatives, there must be legal certainty in respect of the mechanism of submission for clearing²² of such derivatives to a CCP, covering the cases of indirect clearing, including determination of the appropriate legal framework for such submission and standardisation of the related documentation.

35. For the purposes above, submission of a transaction for central clearing is understood as:

- The procedure that involves the termination of an obligation between parties to the initial transaction and the creation between each party to the initial transaction and the CCP of a new obligation with the same subject matter and manner of performance as the original obligation (Diagram 1), or
- The procedure whereby the CCP automatically becomes the counterparty of each party to the transaction as soon as the parties agree on the terms and conditions of the transaction in question. In this event, there is no initial transaction (Diagram 2).

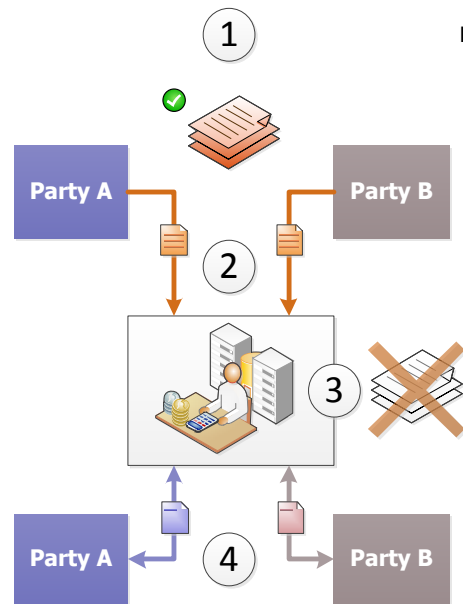
²²For the purposes of this consultation paper, 'indirect clearing' shall mean clearing carried out by a CCP in respect of a derivative to which one or both parties are not clearing participants. In such cases, the derivative is referred to as a client-cleared derivative.

36. Legend to Diagram 1:
1 — The initial transaction entered into between Party A and B (hereinafter referred to as the 'transaction' (1)).

2 — The parties send targeted requests to the CCP or, upon the agreement of the parties, one party sends a joint request.

3 — The CCP matches the requests.

4 — Two transactions are concluded: between the CCP and each party A and B, and the initial transaction (1) is terminated at the same time.



37. Legend to Diagram 2:

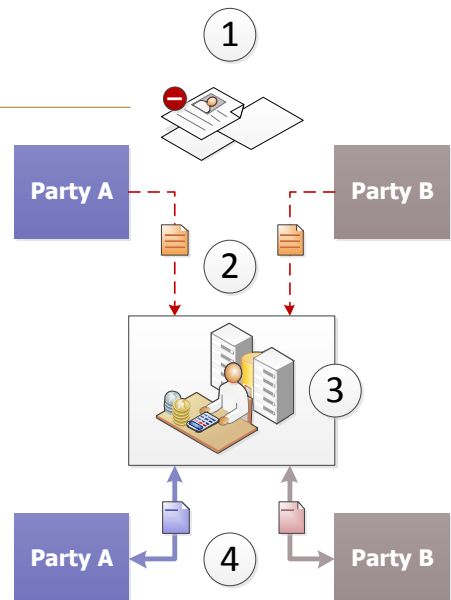
1 — The parties have agreed on the terms and conditions on which they are prepared to enter into the transaction.

2 — Each party sends a targeted request to the CCP.

3 — The CCP matches the requests.

4 — Two transactions are concluded: between the CCP and each party A and B.

No bilateral transaction is made between the parties



I.4.1. The Legal Framework for Submission of Transactions to Central Clearing

38. In respect of the legal device underlying the procedure of submitting a transaction for central clearing the Principles for Financial Market Infrastructure developed by CPSS-IOSCO²³ establish that the CCP becomes a party to transactions with

each party to the initial transaction through novation, open offer or a similar legal device²⁴. The first two of these are most widely used in the international practice. It should be noted, however, that individual elements of the above legal devices may vary from jurisdiction to jurisdiction.

39. In the international practice the above legal devices for submitting transactions for central clearing may also be applied in transactions made

²³Principles for financial market infrastructures, CPSS-IOSCO, 2012. <http://www.bis.org/cpmi/publ/d101a.pdf>.

²⁴Principles for financial market infrastructures, CPSS-IOSCO, 2012, page 9. <http://www.bis.org/cpmi/publ/d101a.pdf>.

through electronic trading systems, where transactions can be executed electronically. Currently, the Bank of Russia is engaged in creating the concept of functioning of such trading infrastructures. One of the objectives of this work is to facilitate the procedure of transactions submitting for central clearing.

I.4.1.1. Submission of a Transaction for Central Clearing through the Legal Device Provided for by the Clearing Law (Undefined Legal Device – ‘Novation’)

40. The concept of ‘novation’ is broader in the international practice than in the Russian law²⁵ because this device includes, among other things, replacement of a contract with several new contracts whose parties may be different from those of the original contract.

41. At the same time the Russian legislation provides for an undefined legal device for the purposes of submission of a transaction for central clearing, which is similar to novation if used in the international context.

42. According to Clause 12, Article 4 of the Law on Clearing rules may stipulate the cases when an obligation existing between the contracting parties, neither of whom is a CCP, is extinguished through replacing such obligation by new obligations between each of the contracting parties and a CCP. The new obligations must have the same subject matter and manner of performance as the initial contract missing the CCP.

43. It should be noted here that, when the device presuming the execution of the initial transaction between the parties is applied, the

transaction should be submitted for central clearing not later than the day of execution of the initial transaction (T0).

44. Non-compliance with the requirement for timely submission of the transaction for central clearing may have administrative legal consequences. In this case such non-compliance must not be the ground to hold the transaction invalid.

45. We assume that in order for the legal device in question to function properly, the following conditions should first be met:

- The agreement of the parties to submit the initial transaction for central clearing does not automatically terminate the initial transaction.

- The moment of the initial transaction termination and of two new transactions execution between each party to the initial transaction and the CCP is the moment when the CCP notifies the parties to the initial transaction that the transaction has been accepted for central clearing. In this case a request sent by the authorized party may be considered as an offer, and the notification sent by the CCP may be considered as the acceptance.

- If the parties to the initial transaction have not received from the CCP the notification of acceptance of the transaction for central clearing, as a general rule the initial transaction is not terminated. The parties may agree otherwise.

- The invalidity of the agreement of the parties to submit the initial transaction for central clearing should not cause the restoration of the initial transaction.

- The obligations of the parties under transactions executed by each party to the initial transaction and the CCP should not depend on obligations arising out of the initial transaction and the parties' agreement to submit the initial transaction for central clearing; as a result, the invalidity of obligations under the initial transaction and/or agreement in question should not affect the validity of obligations arising out of the transactions executed by each party to the initial

²⁵For the purposes of the Russian law (Article 414 of the CC RF), the governing criteria of novation as a method for extinguishing of obligations are as follows: parties to the initial and substitute transactions must be the same; transformation of the initial obligation to a new type of the obligation.

transaction and the CCP²⁶.

I.4.1.2. Submission of a Transaction for Central Clearing through an Open Offer

46. In the international practice the open offer system is a legal device that involves automatic interposition of a CCP between the contracting parties as soon as the buyer and the seller agree on the terms and condition of the transaction^{27,28}.

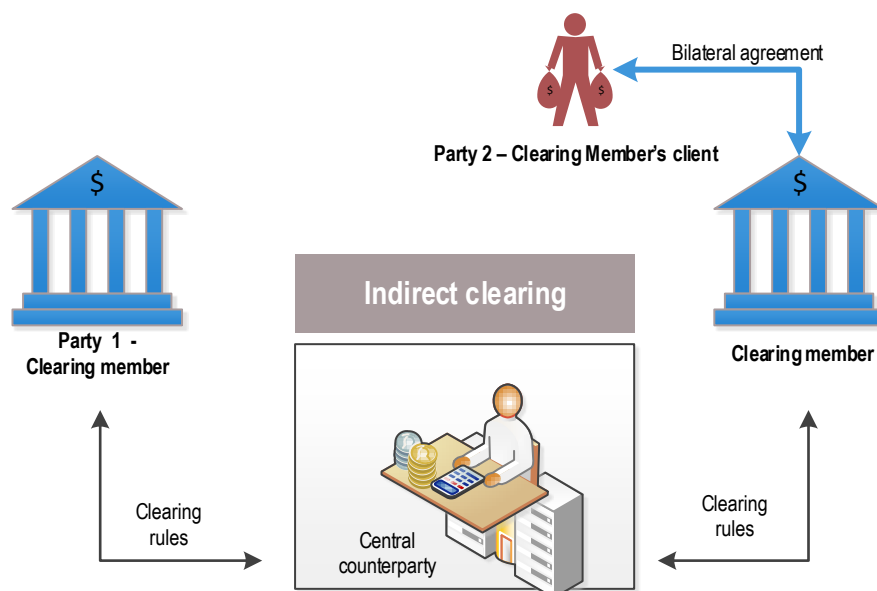
47. We assume, however, that the legal device described in Part 1, Article 19 of the Law on Or-

ganised Trading, which is an analogue to the open offer system, and used in organised trading²⁹ (regulated markets) can also be applied in terms of submission of OTC derivatives for central clearing, provided that each request for a transaction addressed to a CCP will incorporate the information on the CCP's counterparty under the 'opposite' transaction.

48. This Section also examines special features of participants' interaction during indirect clearing. This system is presented in Diagram 3.

49. The following are widely used models for interaction of clearing members and clearing mem-

Diagram 3



²⁶ A similar approach is taken, for example, in Germany, where the 'abstract novation' (Abstrakte Novation) has been adopted and, by way of illustration, directly stipulated in the clearing rules of Eurex Clearing AG (http://www.eurexchange.com/blob/exchange-de/4188-139212/115098/50/data/clearing_conditions_de.pdf_ab-2014_02_10.pdf), to achieve the described legal effect. For more detail, see Philipp J. Gergen, Rechtsfragen der Regulierung außerbörslicher derivativer Finanzinstrumente. Pages 67–68.

²⁷ Principles for financial market infrastructures, CPSS-IOSCO, 2012, page 9. <http://www.bis.org/cpmi/publ/d101a.pdf>.

²⁸ In the Russian law offer and acceptance under Articles 432, 435, 438 of CC RF are nothing more than a manner of contract execution, which involves no mechanism for automatic interposition of a third party (CCP) between the parties to the contract.

²⁹ In accordance with Part 1, Article 19 of the Law on Organised Trading, unless otherwise required by this Federal Law, the CCP enters into a contract with each trading participant whose registered opposite requests have been found by the trading organiser to match each other. In this case no request need be submitted to the CCP, and each of the above contracts is deemed executed at the moment the trading organiser records a match between requests by making an entry on the execution of contracts with the CCP in the contracts register.

bers' clients when a client's transaction is submitted for central clearing: the agency model and the principal-to-principal model³⁰.

50. The agency model is used, for example, in the USA, Canada, and other jurisdictions³¹ and assumes that once the transaction has been accepted for central clearing, the clearing member is not an independent party to the transaction in its relationships with the CCP, but rather acts as the client's agent and the guarantor of the client's obligations to the CCP under the transaction.

51. The latter, the principal-to-principal model, is widely used in EU countries (England, Austria, and others) and assumes that once the transaction has been accepted for central clearing, the clearing member enters into two symmetric transactions: 1) one transaction is between the clearing member and the clearing member's client (contains the terms of the initial transaction); 2) the second transaction is between the clearing member and the CCP (contains the opposite position of the clearing member in respect of the first transaction).

52. Taking into consideration the above, we suppose that the principal-to-principal model of transaction is the most acceptable one in terms of submission of the client's transactions for central clearing within the Russian legal framework and the existing business practice.

53. However, we assume that, in terms of the Russian regulation, the mechanism described in Clause 12, Article 4 of the Law on Clearing is not applicable to the submission of a client's transaction for central clearing. This finding is based on the fact that this rule allows only a party to the initial transaction to become a party under the new obligation arising after the transaction has been accepted for central clearing. Therefore, for the

purposes of submitting a client's transaction for central clearing the existing provisions of the above Article make the commission model (Article 990 of CC RF) inapplicable to relations between the clearing member and the clearing member's client. At the same time, the relationship cannot be structured pursuant to the agency model (Article 971 of CC RF) for this purpose either, because the CCP must not assume the credit risk associated with persons that are not clearing members, as stated in Clause 1, Article 3 of the Law on Clearing.

54. Taking into consideration the above, we suppose that the existing provisions of Clause 12, Article 4 of the Law on Clearing should be amended to enable their application to the submission of the client's transactions to central clearing.

I.4.2. The Standard Documentation Facilitating the Submission of Derivatives for Central Clearing

55. We believe that the relevant standard documentation for the submission of a transaction for central clearing must be drafted with regard to:

- Contracts setting up the legal relationship between the parties that submit individual transactions for central clearing.
- Contracts and other documentation³³ setting up the legal relationship between a clearing member and such clearing member's client arising from the submission of the client's transaction for central clearing.

³⁰It should be pointed out, however, that both models are used in some jurisdictions at the same time.

³¹Published on the ISDA official website at http://www.isda.org/docproj/stat_of_clear_fcm.html.

³²Published on the ISDA official website at http://www.isda.org/docproj/stat_of_clearing_members_reliance.html.

³³Such documentation may be drafted in cooperation with self-regulated organisations.

Questions for Section I.4

16. Do you have any comments/suggestions regarding the abovementioned legal devices for submitting a transaction for central clearing, and any suggestions on their improvement? If you do, please provide specific details.

17. Do you have any comments/suggestions regarding the proposed term (T0) to transfer a transaction to central clearing when the system relying on the execution of the initial transaction between the parties is applied? If you do, please provide specific details

18. Do you have any comments/suggestions regarding the principal-to-principal transaction model in terms of submitting a client's transaction for central clearing? If you do, please provide specific details.

19. Do you have any comments/suggestions regarding the need of any improvements to the provisions of Clause 12, Article 4 of the Law on Clearing in terms of their applicability to the submission of a client's transaction for central clearing? If you do, please provide specific details.

20. Do you have any comments/suggestions regarding the standardisation of documentation facilitating the submission of transactions, including clients' transactions, for central clearing? If you do, please provide specific details.

21. Do you have any proposals regarding the need to standardise any other documentation? If you do, please provide specific details.

SECTION II. REQUIREMENTS ON COLLATERAL FOR NON-CENTRALLY CLEARED STANDARDIZED OTC DERIVATIVES

56. With reference to the international standards and recommended methodologies, including the provisions of Basel III³⁴ developed by BCBS, and recommendations on margin requirements for non-centrally cleared OTC derivatives³⁵ developed by BCBS in conjunction with IOSCO, the Bank of Russia is evaluating the possibility of introducing collateral requirements in respect of non-centrally cleared OTC derivatives.

57. Specific proposals will be put forward for public discussion in another consultation paper of the Bank of Russia.

Questions for Section II

22. Do you have any suggestions regarding the introduction of a collateral requirement for non-centrally cleared OTC derivatives? If you do, please provide specific details.

³⁴Basel III: A global regulatory framework for more resilient banks and banking systems, BCBS, 2011. <http://www.bis.org/bcbs/basel3.htm>.

³⁵Published Margin requirements for non-centrally cleared derivatives, BCBS, the IOSCO Board, 2015. <http://www.bis.org/bcbs/publ/d317.pdf>.

SECTION III. REPORTING OF CENTRALLY CLEARED STANDARDIZED OTC DERIVATIVES TO A TRADE RE- POSITORY

58. This section contains the position of the Bank of Russia on providing information on centrally cleared standardised OTC derivatives to a trade repository.

59. The results of the analysis of foreign laws suggest that the transactions submitted for central clearing are not exempted from the requirement to provide information to the trade repository.

60. For example, Article 9 of EMIR³⁶ imposes the following requirements in pursuance of the G20 resolution regarding provision of information on standardised OTC derivatives to a trade repository:

- Counterparties and the CCP should provide for the details of the derivative they have executed, as well as any changes to or termination of the derivative, to be submitted to the trade repository. Information on the executed derivative should be provided to the trade repository on or before the business day following the day of its execution, modification, or termination.

- Counterparties or the CCP, which are obligated to provide information on derivatives to the trade repository, may delegate the reporting of the details of the derivative in question to another entity.

- Counterparties or the CCP should provide for the details of derivatives to be submitted without duplication.

61. ESMA's Final Report, dated November 13th, 2015, 'Review of the Regulatory and Implementing Technical Standards on Reporting under Article 9 of EMIR' indicates that if the executed contract has been submitted for central clearing, the information should be provided to the trade repository both on the termination of the contract in question and the execution of the new contracts with a CCP.

The Dodd-Frank Act³⁷ also includes provisions requiring that information on each swap contract (that has or has not been cleared) should be provided to the authorised trade repository (swap data repository). If the swap contract has been cleared, information on the contract is provided to the repository in real time in accordance with Section 727 of the Dodd-Frank Act. The Dodd-Frank Act contains no direct indication as to who should provide information on the cleared swap contract to the repository. However, it establishes the requirement that information should be provided to the repository unilaterally. Therefore, this document indirectly offers an alternative approach to the provision of information to the trade repository – that is, with the consent of the parties: by the counterparty or CCP.

62. It should be pointed out that the current version of Clause 6, Article 51.5 of the Law on the Securities Market³⁸ allows the Bank of Russia to

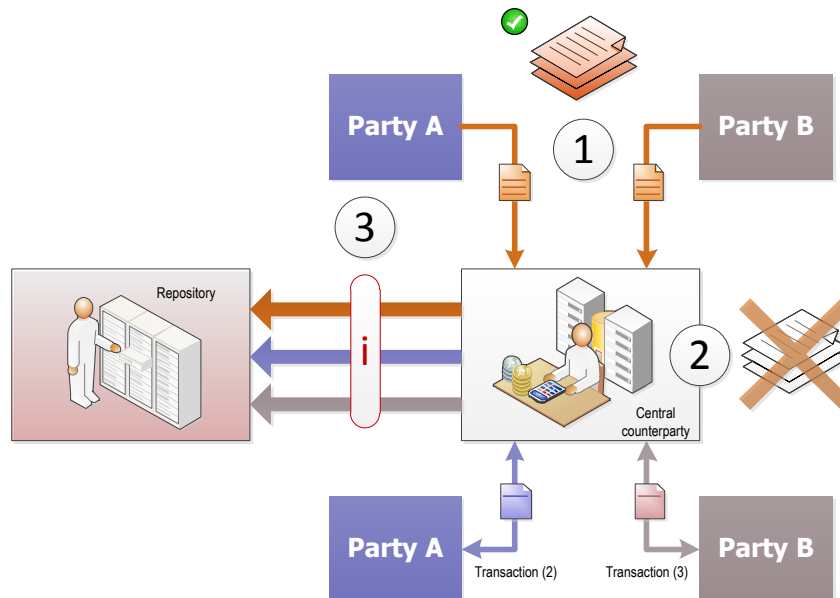
³⁶Published Article 9 of Regulation (EU) No 648/2012 of the European Parliament and of the Council, dated July 4th, 2012, on OTC derivatives, central counterparties, and trade repositories. <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R2205&from=EN>.

³⁷This document is available at <https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>.

³⁸Federal Law 430-FZ, dated December 30th, 2015, 'On Amending the Federal Law on the Securities Market' establishes these powers in Clause 1, Article 15.8 of the Law on the Securities Market. This rule took effect on June 28th, 2016.

Diagram 4

Provision of information to the trade repository regarding a transaction submitted for central clearing through novation (Section I.4.1.1. of this consultation paper)



determine the list of persons obliged to provide information to the trade repository. Therefore, the existing law, subject to adopting the respective regulation by the Bank of Russia, allows to report standardised OTC derivatives to the trade repository either by the counterparty or the CCP even if these derivatives shall be centrally cleared.

63. In addition, one should take into account the trend existing in foreign practice where a standardised OTC derivative is reported to the trade repository unilaterally.

64. Since the Bank of Russia is considering the adoption of the reporting requirement only in respect of certain financial market participants, the approach, where centrally cleared standardised OTC derivatives are reported to the trade repository only by the CCP³⁹, is deemed to be the most effective (Diagram 4, Diagram 5).

65. Legend to Diagram 4:

1 — The initial transaction is entered into between parties A and B (hereinafter referred to as the 'transaction' (1)).

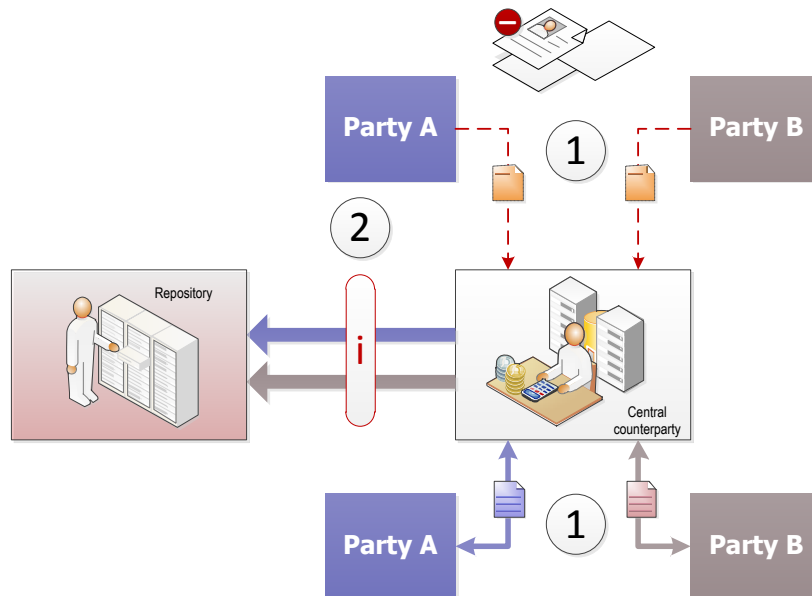
2 — Transaction (1) is submitted for central clearing (transaction (1) is terminated and, at the same time, two transactions (2) and (3) are entered into between the CCP and each party A and B, respectively).

3 — The CCP provides information to the trade repository on the execution and termination of the transaction (1) and the execution of the transaction (2) and (3).

³⁹If a transaction subject to mandatory central clearing has not been accepted by the CCP, the parties thereto must provide the information on execution of such transaction to the trade repository themselves as per the procedure established by the Ordinance on Reporting to Trade Repository.

Diagram 5

Provision of information to the trade repository regarding a transaction submitted for central clearing through an open-offer (Section I.4.1.2. of this consultation paper)



66. Legend to Diagram 5:

1 — Transaction (2) and (3) are entered into between the CCP and each party A and B, respectively.

2 — The CCP provides information to the trade repository on the execution of the transaction (2) and (3).

Questions for Section III

23. Do you have any comments/suggestions regarding the described approach to the provision of information to the trade repository on a standardised OTC derivative, which has been submitted for central clearing? If you do, please provide specific details.

