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Changes to the Russian Reporting Regime: Real Improvement or Wishful Thinking?

This client briefing discusses the recent changes to the trade reporting regime in Russia and their impact on the market and, in particular, the enforceability of close-out netting arrangements.

BACKGROUND

As you may know, the trade reporting requirements (trade reporting also being one of the pre-requisites for the recognition of close-out netting arrangements in Russian insolvency) were introduced by the Russian Securities Market Law and further detailed in the trade reporting regulation No. 11-68/pz-n (the "**Reporting Regulation**") adopted by the Russian Federal Service for Financial Markets ("**FSFM**") in December 2011. Parties (both incorporated in and outside Russia) to derivative transactions, repos and FX and securities transactions were required to report the execution of the relevant master agreement and transactions (as well as certain other trade-related information) to a Russian trade repository who would, in turn, report to FSFM (whose functions have now been assumed by the Russian Central Bank).

Trade reports must be provided by a "reporting entity" (*informiruyesheye litso*) (which can be either one party, both parties or a designated third party). Where both parties are designated as "reporting entities", the entry of the relevant information in the register was conditional on the trade repository receiving identical, matching reports from both parties.

However, regardless of that determination, in order to be able to report, both parties to reportable transactions were required to undergo KYC checks and register, and execute trade repository services agreements, with one of the Russian trade repositories.

FSFM have established two principal compliance dates for the commencement of trade reporting: 5 November 2013 - for repos and FX swaps and 25 June 2014 – for other transactions (which was later deferred until 1 January 2015).

PRINCIPAL CHANGES

As the implementation of the original reporting regime was anything but flawless and was accompanied by, among other things, trade repositories struggling with IT and technological issues and non-Russian market participants having to deal with the lengthy and cumbersome KYC and registration process, the Central Bank has made a decision to introduce a number of changes to the trade reporting requirements through the amendments to the Securities Market Law and the Central Bank Directive No. 3253-U (the "**Directive**") (with the new regime becoming effective on 1 October 2014).

Devolution of Powers to the Central Bank

While initially both the range of reporting parties and the scope of reportable products were dealt with in the Securities Market Law, in order to provide greater flexibility in managing the trade reporting regime, in July 2014, the Securities Market Law was amended to allow the Central Bank to determine who needs to report and what needs to be reported.

Non-Russian Entities and Individuals No Longer Required to Report

The Directive provides that, with effect from 1 October 2014, the entities that are required to provide trade reporting are the following entities ***incorporated in Russia***:

- banks and other credit institutions;

- brokers and dealers;
- securities managers;
- custodians and registrars;
- private pension funds;
- insurance companies;
- management companies of investment funds, mutual investment funds and private pension funds;
- joint stock investment funds; and
- organisers of trading (that is, stock and other exchanges) and clearing houses.

Therefore, non-Russian market participants, Russian corporates and Russian and non-Russian individuals no longer have an obligation to report to a Russian trade repository (however, they may still choose to do so voluntarily in order to be certain they satisfy the conditions for close-out netting).

Reduction of the Range of Reportable Transactions

Alongside the abolition of reporting obligations for non-Russian entities and individuals, the Central Bank decided to reduce the range of reportable transactions to over-the-counter repos, FX swaps and transactions classified as derivatives by the Central Bank or its predecessors (currently contained in the FSFM Order No. 10-13/pz-n) provided that they are entered into under a master agreement.

Accordingly, it is no longer necessary to report "other transactions" (namely, FX and securities-related transactions, such as, for example, stocklending transactions).

Further Extension of Compliance Date 2

The final principal change is the further extension of the second compliance date for reporting transactions other than FX swaps and repos from 1 January to 1 April 2015.

ARE WE THERE YET?

Given the impact of the above changes, as the cost and logistical burden of Russian reporting is not insignificant, one may be inclined to discontinue reporting (or abort the KYC and registration process with a Russian trade repository) and instead rely on the Russian counterparty to lodge the relevant reports.

However, to our mind, while this approach addresses the formal compliance with the Russian law requirements, non-Russian counterparties (particularly financial institutions) need to consider whether such reliance on the Russian counterparties to correctly and comprehensively report would allow them to satisfy the regulatory capital requirements in their home jurisdiction and treat the relevant positions as net.

Also, in a situation where the non-Russian market participants transact with Russian entities that are not under an obligation to report (such as, for example, Russian corporates), there is a risk that neither party would report to a Russian trade repository, and, therefore, the relevant exposure would have to be calculated on a gross basis.

WHAT COMES NEXT?

In their discussions with the market, the Central Bank have indicated that they are considering further revisions to the Securities Market Law and the Directive which are likely to cover the following points:

- the range of reportable transactions are likely to be expanded to also include all derivatives, repos and FX swap transactions (regardless of whether they are documented under a master agreement);
- they may extend the list of counterparties that are required to report to include major Russian corporates;
- it is possible that the data in the Russian trade register would no longer prevail per se and the Central Bank would allow non-Russian market participants to support their calculation of close-out amounts by referring to their trade reports filed with eligible non-Russian trade repositories (including reporting under EMIR); and
- alternatively, any mismatch between the parties' records as to the existence and the terms of the agreements would result in an evidentiary dispute (to be considered by an insolvency court on its merits).

The Central Bank have mentioned that the above changes may become effective in 2015 but, if history is anything to go by, these dates should be treated as a guesstimate rather than a firm commitment.

Authors

Tamer Amara
Partner

T: +7 495 725 6449
E: tamer.amara
@cliffordchance.com

Alexander Anichkin
Partner

T: +7 495 258 5089
E: alexander.anichkin
@cliffordchance.com