



Bank of Russia

The Central Bank of the Russian Federation



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Consultation Paper

**ON MANDATORY  
MARGINING  
OF NON-CENTRALLY  
CLEARED  
OTC DERIVATIVES**

MOSCOW



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\*This is an unofficial translation for information purposes only. If there are any discrepancies between the original Russian version and this translated version, the original Russian version shall prevail.

## ABBREVIATIONS

**BCBS** — Basel Committee on Banking Supervision

**G20** — The Group of Twenty

**FSB** — Financial Stability Board

**IOSCO** — International Organization of Securities Commissions

**ISDA** — International Swaps and Derivatives Association

**Variation Margin** — deposit (security) margin intended to cover the current exposure of a position (positions) caused by actual changes in the market prices for the underlying assets of derivatives

**CC RF** — Civil Code of the Russian Federation

**Directive 2002/47/EC** — Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements

**Law on Banks** — Federal Law No. 395-1, dated 2 December 1990, 'On Banks and Banking Activities'

**Law on Bankruptcy** — Federal Law No. 127-FZ, dated 26 October 2002, 'On Insolvency (Bankruptcy)'

**Law on the Securities Market** — Federal Law No. 39-FZ, dated 22 April 1996, 'On the Securities Market'

**Instruction 139-I** — Bank of Russia Instruction No. 139-I, dated 3 December 2012, 'On Banks' Statutory Ratios'

**Haircut** — a discount applicable to the price of an asset provided as an Initial or Variation Margin to cover possible change in its value during the period between the last revaluation of the asset and time of its sale

**Margining** — provision by one party of a derivative to the other party or exchange of assets (margin payments) between such parties to secure their performance under the derivative

**Initial Margin** — deposit (security) margin intended to cover potential change in a counterparty's position in derivatives (potential exposure) during the liquidation period of such position (positions) upon the counterparty's failure to discharge its obligations

**IFRS** — International Financial Reporting Standards

**NSD** — National Settlement Depository

**NCC derivatives** — derivatives which are not cleared through a central counterparty (non-centrally cleared derivatives)

**Derivative** — a contract which is a derivative financial instrument in accordance with the laws of the Russian Federation, unless otherwise specified herein

**Repository** — a legal entity conducting repository activity in accordance with the laws of the Russian Federation

**DB** — Derivatives Board

**Ordinance 3565-U** — Bank of Russia Ordinance No. 3565-U, dated 16 February 2015, 'On Types of Derivative Financial Instruments'

**CCP** — central counterparty

## INTRODUCTION

*In 2011 the G20 leaders decided that it would be expedient to adopt mandatory margining of non-centrally cleared derivatives to enhance the stability of the financial system<sup>1</sup>. This decision complemented the program for reforming the OTC derivatives market approved at the G20 summit in Pittsburgh in 2009<sup>2</sup>. The purpose of this Consultation Paper is to present approaches for implementing the obligations assumed by Russia for phasing in the mandatory margining requirement for non-centrally cleared derivatives, for widespread discussion with financial market participants.*

*The joint standards document of the BCBS and IOSCO 'Margin Requirements for Non-Centrally Cleared Derivatives' (published in March 2015)<sup>3</sup> (hereinafter 'the BCBS-IOSCO Standards') mentions that the purpose of introducing mandatory margining of non-centrally cleared derivatives is to reduce systemic risk. A great deal of derivatives are not standardised and, therefore, cannot be cleared through a CCP. Margining requirements are meant to prevent a series of defaults (cross-defaults) if one of the parties to a derivative fails to discharge its obligations by using the collateral to repay the debt. Margin requirements can also have a broader positive effect by reducing the financial system's vulnerability to destabilizing procyclicality and limiting the build-up of uncollateralised exposures on the financial market.*

*Furthermore, margin requirements for non-centrally cleared derivatives which reflect the higher risks associated with such derivatives promote the standardisation of OTC derivatives and, as a result, the clearing of standardised OTC derivatives with the participation of CCPs.*

*The BCBS-IOSCO Standards contain eight main elements which were used as the basis for preparing this Consultation Paper:*

*1) Appropriate margining practices should be in place with respect to all derivatives transactions that are not cleared by CCPs (considering the exception set for some deliverable derivatives).*

*2) All financial organisations and systemically important non-financial entities that engage in OTC derivatives must exchange Initial and Variation Margins corresponding to the counterparty risks posed by such transactions (using the appropriate threshold values).*

*3) The methodologies for calculating Initial and Variation Margins should: (i) be consistent across entities covered by the requirements for mandatory margining of non-centrally cleared derivatives; (ii) reflect the potential exposure (Initial Margin) and current exposure (Variation Margin) associated with the portfolio of derivatives in question; and (iii) ensure that all counterparty risk exposures are fully covered with a high degree of confidence.*

*4) Assets collected as margin should be highly liquid and should, after accounting for an appropriate haircut, be able to preserve their value in a time of financial stress. The purpose of this element is to enable prompt liquidation of the collateral in the amount required to cover losses resulting from a counterparty's default on the derivative.*

*5) Initial Margin should be exchanged by both parties, without netting of amounts collected by each party (i.e., on a gross basis), and held in such a way as to ensure that (i) the margin collected is immediately available to the collecting party in the event of the counterparty's default; and (ii) the collected*

<sup>1</sup>Leaders' Statement, The Cannes Summit, Cannes November 4, 2011, <http://www.g20.utoronto.ca/2011/2011-cannes-declaration-111104-en.html>

<sup>2</sup>Leaders' Statement, The Pittsburgh Summit, September 24-25, 2009, [http://www.fsb.org/wp-content/uploads/g20\\_leaders\\_declaration\\_pittsburgh\\_2009.pdf](http://www.fsb.org/wp-content/uploads/g20_leaders_declaration_pittsburgh_2009.pdf)

<sup>3</sup><http://www.bis.org/bcbs/publ/d317.htm>

*margin must be subject to arrangements that fully protect the posting party to the extent possible under applicable law in the event that the collecting party enters bankruptcy.*

*6) Transactions between a firm and its affiliates should be subject to appropriate regulation by national supervisors in a manner consistent with each jurisdiction's legal and regulatory framework.*

*7) Regulatory regimes should interact so as to result in sufficiently consistent and non-duplicative regulatory margin requirements across jurisdictions.*

*8) Margin requirements should be phased in to reduce the costs incurred by market participants in connection with the change in regulation.*

*The approaches introduced in this Consultation Paper are based on an analysis of the current state of the Russian derivatives market and regulatory practices in Canada, the European Union, Hong Kong, Japan and the USA, with due regard for the best practices elaborated by international professional associations in this area<sup>4</sup>.*

*The suggested approaches were preliminarily reviewed at the DB meeting.*

*The Bank of Russia's Financial Markets Development Department invites comments on this Consultation Paper, including answers to the questions raised, and other comments and suggestions, to be sent to the following address (e-mail): [svc\\_derivatives@cbr.ru](mailto:svc_derivatives@cbr.ru) until 1 June 2017.*

*In addition, the Bank of Russia plans to perform a series of on-site consultations with representatives of the professional community, inter alia, on the platforms of self-regulatory organisations in the field of financial markets and other professional associations.*

*Following these consultations, the Bank of Russia will report on the comments and suggestions it has received and on its final approaches to the adoption of mandatory margining of non-centrally cleared derivatives.*

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<sup>4</sup>Including recommendations and standards developed by ISDA.

## KEY PROPOSALS

This Consultation Paper contains the following key propositions of the Bank of Russia on approaches to implementing the decisions adopted by the G20 on introducing a requirement for mandatory margining of non-centrally cleared derivatives:

1. To start phase-in of the requirement for mandatory margining of non-centrally cleared derivatives from 1 July 2018, depending on the category of financial market participants and the threshold values based on the volume of transactions:

a) To establish the following categories of financial market participants:

- Category 1: credit institutions and professional participants in the securities market that are licenced for dealer and/or brokerage activities and/or securities management, as well as organisations that are licenced as management companies for investment funds, unit investment funds, or non-governmental pension funds. This category also includes foreign entities which are entitled under their *lex societatis* to conduct banking activity or professional securities market activity.

- Category 2: other corporate participants of the OTC derivatives market. This category includes entities making Derivatives on the OTC market which do not belong to Category 1, including foreign entities.

b) To start adoption of the requirement for mandatory transfer of Initial and Variation Margins for participants of Category 1 (upon their attainment of the necessary threshold value for the aggregate month-end notional amount of NCC derivatives for the three assessment months calculated on a group basis, in the amount of 100 billion RUB for Variation Margin and in the amount of 600 billion RUB for Initial Margin) from 1 July 2018.

c) To start adoption of the requirement for mandatory transfer of Initial and Variation Margins for participants of Category 2 (upon their attainment of the necessary threshold value for the aggregate month-end notional amount of NCC derivatives for the three assessment months calculated on a group basis, in the amount of 100 billion RUB for Variation Margin and in the amount of 600 billion RUB for Initial Margin) from 1 July 2019.

2. To introduce a minimum transfer amount, not to exceed 100 million RUB, which the party to a Derivative may not claim from its counterparty as a margin payment.

3. To set basic requirements to the Initial and Variation Margin in respect of the calculation deadlines and procedure, as well as the deadline for transfer until the business day following the day of calculation.

4. To establish the possibility of using the legal framework of title transfer collateral and security interest (pledge) for the purpose of complying with the requirements for mandatory margining of non-centrally cleared derivatives.

5. To initiate the elaboration and distribution of standard documents with the active participation of the DB.

6. To create a special regime for NCC derivatives with foreign participants which would enable the avoidance of duplicate regulatory requirements or regulatory arbitrage.

7. To prepare a legal framework for the development of security management services and portfolio compression services for NCC derivatives, and the implementation of modern risk management procedures by the entities covered by the requirement for mandatory margining of NCC derivatives.

## CHAPTER 1. CATEGORIES OF DERIVATIVES SUBJECT TO MANDATORY MARGINING

The BCBS-IOSCO Standards contain margin requirements for all NCC derivatives except for Initial Margin posted for physically settled FX forwards and swaps<sup>5</sup>. There is also a special regime provided for cross-currency swaps<sup>6</sup>.

In some countries, a mandatory margining requirement does not cover all or certain deliverable commodity derivatives<sup>7</sup>.

Table 1 shows the status of adoption of a margin requirement for NCC derivatives across jurisdictions.

information about which is to be provided to the repository. Furthermore, NCC derivatives specified in Table 2 shall mean the following contracts.

**A physically settled FX forward** is a physically settled forward contract, as defined in Ordinance No. 3565-U, which provides solely for the exchange of two different currencies on a certain date at a fixed exchange rate agreed upon on the effective date of such forward contract.

**A physically settled FX swap** is a physically settled swap contract, as defined in Ordinance

Table 1

**Status of adoption of a margin requirement for NCC derivatives across jurisdictions in accordance with the BCBS-IOSCO Standards**

<b>European Union countries</b>	The requirement for the transfer of Variation Margin applies to all covered entities since 1 March 2017. The requirement for the transfer of Initial Margin will be phased in from 4 February 2017 through 1 September 2020.
<b>Hong Kong</b>	The requirement for the transfer of Variation Margin came into force on 1 March 2017. The requirement for the transfer of Initial Margin will be phased in from 1 March 2017 through 1 September 2020.
<b>Canada</b>	Regulation came into force on 1 September 2016 and will be phased in according to the schedule presented in the BCBS-IOSCO Standards.
<b>United States</b>	Regulation came into force on 1 September 2016 and will be phased in according to the schedule presented in the BCBS-IOSCO Standards.
<b>Japan</b>	Regulation came into force on 1 September 2016 and will be phased in according to the schedule presented in the BCBS-IOSCO Standards.

Table 2 shows the Bank of Russia's proposals for adopting a mandatory margining requirement for the derivatives.

A mandatory margin requirement for NCC derivatives is planned to cover only those derivatives,

No. 3565-U, which provides solely for the exchange of two different currencies on a certain date at a fixed exchange rate agreed upon on the effective date of such swap contract, and the return exchange of the said currencies on a later

<sup>5</sup>That said, the BCBS-IOSCO Standards contain a reference to the supervisory guidance published by BCBS which sets recommendations for banks regarding the exchange of Variation Margin under physically settled FX forwards and swaps with counterparties which are financial institutions or systemically important non-financial institutions. Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions <http://www.bis.org/publ/bcbs241.pdf>.

<sup>6</sup>For cross-currency swaps with the exchange of principal, the BCBS-IOSCO standards require a special regime, according to which:

- Initial Margin is not applied to the principal component of the derivative.
- Initial Margin is applied to the interest-rate component of the derivative using a standard or quantitative calculation model.
- Variation Margin is applied to both components of the derivative (principal and interest-rate).

<sup>7</sup>E.g., in Canada, Hong Kong, and Japan.

Table 2

**Requirement for mandatory margining depending on the category of NCC derivatives**

	Physically settled FX forwards and swaps; Physically settled commodity derivatives	Cross-currency swaps with the exchange of principal	All other NCC derivatives
	Margin requirement		
<b>Initial Margin</b>	Not applicable	Applicable with due regard to the specific features of the derivative	Applicable
<b>Variation Margin</b>	Not applicable	Applicable	

date at a fixed rate agreed upon on the effective date of such swap contract.

**A cross-currency swap with the exchange of principal** is a contract containing the terms of a physically settled FX swap and also providing for the obligation of the party or parties thereto to pay interest periodically and/or on a lump sum basis on the notional amount or amounts established in the contract<sup>8</sup>.

**A physically settled commodity derivative** is a physically settled option, forward, or swap contract, as defined in Ordinance No. 3565-U, which provides for the obligation of one party to deliver a commodity to the other party within a certain period of time<sup>9</sup>.

**Questions for Chapter 1**

1. Do you think that the categories of NCC derivatives as per Table 2 which are subject to mandatory margining are optimal? If not, please explain and suggest alternatives, if possible.

2. Do you consider it is necessary to exclude from the list of derivatives subject to mandatory margining, derivatives with duration less than 30 calendar days? If yes, please suggest possible exceptions and provide the appropriate substantiation.

<sup>8</sup> Leaders' Initial Margin is not posted for the principal component of the derivative, but is posted for the interest-rate component of the derivative.

<sup>9</sup> The exception does not cover mixed contracts which provide for another underlying asset apart from the commodity to be delivered thereunder, and the contracts with the features of a cash settled derivative.

## CHAPTER 2. CATEGORIES OF FINANCIAL MARKET PARTICIPANTS (ENTITIES) COVERED BY THE REQUIREMENT FOR MANDATORY MARGINING OF DERIVATIVES

According to Clause 2.4 of the BCBS-IOSCO Standards, mandatory margining requirements shall apply to all financial institutions and systemically important non-financial institutions, with due regard to the achievement of the relevant threshold values by the counterparties to the derivatives. However, the said requirements shall not apply to transactions to which central banks, public entities, multilateral development banks, and/or the Bank for International Settlements are parties.

### 2.1. General Rules on Covered Entities

Based on the relevant international experience and taking into consideration the potential scope of the participation of Russian participants in transactions with derivatives, the Bank of Russia will distinguish two categories of entities which shall be covered by the requirement for mandatory margining of NCC derivatives.

Category 1: credit institutions and professional participants in the securities market that are licenced for dealer and/or brokerage activities and/or securities management, as well as organisations that are licenced as management companies for investment funds, unit investment funds, or non-governmental pension funds. This category also includes foreign entities which are entitled under their *lex societatis* to conduct banking activity or professional securities market activity.

Category 2: other corporate participants of the OTC derivatives market. This category includes

entities trading derivatives on the OTC market which do not belong to Category 1, including foreign entities.

### 2.2. Exceptions to the General Rules on Covered Entities

The Bank of Russia is considering the possibility of establishing the following exceptions to the general requirement for mandatory margining of NCC derivatives:

- Intra-group derivatives
- Derivatives with certain entities

#### 2.2.1. Intra-Group Derivatives

This exception is based on the fact that the risks associated with executing NCC derivatives arise centrally within one group, allowing the parties to the derivative to organise appropriate management of such risks.

The expediency of making transactions between members of the same group an exception to the general requirement for mandatory margining of NCC derivatives is recognized in many legal systems<sup>10</sup>.

In the Russian legal framework, it is proposed that all of the following conditions must be met simultaneously in order for an exception to be applied based on the 'Intra-Group Derivatives' criterion:

a) The parties to a derivative should belong to the same 'group'. The category of 'control' defined in IFRS 10, Consolidated Financial Statements,<sup>10</sup> is proposed for consideration as a criterion to identify a 'group'.

<sup>10</sup>Regulation in Canada, the European Union, Hong Kong, and Japan may be cited as an example.

Table 3

## Stages of introducing a mandatory margin requirement

Threshold Value		Categories of participants between which a NCC derivative transaction is executed	Entry into force of the requirement (stage)
<b>Variation Margin</b>			
RUB 100 billion		Category 1 and Category 1	from 1 July 2018
		Category 1 and Category 2	from 1 July 2019
No threshold value		Category 1 and Category 1	from 1 July 2019
For Category 1 no threshold value	For Category 2 RUB 80 billion	Category 1 and Category 2	from 1 July 2020
<b>Initial Margin</b>			
RUB 600 billion		Category 1 and Category 1	from 1 July 2018
		Category 1 and Category 2	from 1 July 2019
RUB 300 billion		Category 1 and Category 1	from 1 July 2019
		Category 1 and Category 2	from 1 July 2020
RUB 150 billion		Category 1 and Category 1	from 1 July 2020
		Category 1 and Category 2	from 1 July 2021
RUB 80 billion		Category 1 and Category 1	from 1 July 2021
		Category 1 and Category 2	from 1 July 2022

b) The activities of the parties to the derivative involve the complete consolidation of IFRS financial statements<sup>11</sup>.

c) The parties to the derivative have given the Bank of Russia notice of the application of the exception for Intra-Group Derivatives in the form established by the Bank of Russia before entering into the derivative.

### 2.2.2. Derivatives with Certain Entities

It is suggested that this category includes derivatives with the Bank of Russia, state and municipal bodies, international financial institutions (such as the International Finance Corporation and the European Bank for Reconstruction and Development), and the central banks of foreign states specified in Subclauses 1 and 2 of Clause 2, Article 51.1 of the Law on the Securities Market.

## 2.3. Threshold Values Above Which the Mandatory Margining Requirement Shall Apply

In the light of international experience and the requirements set forth in the BCBS-IOSCO Standards, the Bank of Russia proposes phasing in the requirement for mandatory margining of NCC derivatives. Each stage has a corresponding threshold value from Table 3.

In order to determine the need to start margining, it is proposed to calculate the aggregate notional amount of the NCC derivatives entered into by the group of which the entity in question from Category 1 or Category 2 is a member. Calculation is made as of the end of each of the three assessment months, where:

1. Only categories of derivatives subject to mandatory reporting to a repository will be used for calculation.

<sup>11</sup>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 28 December 2015 No. 217n).

2. It is suggested that the category of 'control,' as defined in IFRS 10 'Consolidated Financial Statements', be used as a criterion to identify the 'group' of which the entity in question from Category 1 or Category 2 is a member.

3. NCC derivatives, entered into between entities within the same group, shall also be used in calculation (each NCC derivative shall only be taken into account once).

4. March, April, and May are proposed as assessment months. If the threshold value is exceeded as of the end of each of those three months, margining shall be mandatory for the respective NCC derivatives executed from October 1 of the same year.

To extend the mandatory margin requirement for NCC derivatives to a particular transaction each counterparty shall exceed the threshold value.

The mandatory margin requirement for NCC derivatives shall only apply to new NCC derivatives entered into after the effective date of the respective requirement for mandatory margining of such transactions.

When applying this approach, each party to a transaction must have reliable information on the exceedance/non-exceedance of the threshold value by

the counterparty's group in order to make a decision on margining of the NCC derivatives entered into with the counterparty. Counterparties are expected to provide each other the said information on the basis of a standard notification form developed by the DB, which will be exchanged before executing the transaction, . An example of such an approach is the Regulatory Margin Self-Disclosure Form developed by ISDA.

### **Minimum transfer amount**

In addition to the threshold values specified in Table 3, it is proposed to introduce a rule on de minimis amount (sum) posted as Initial and/or Variation Margin for NCC derivatives (the 'Minimum Transfer Amount').

The Minimum Transfer Amount is the maximum amount which a party to a NCC derivative may not demand from its counterparty. The Bank of Russia finds it expedient to allow Category 1 and/or Category 2 participants to stipulate in their contracts that a party is entitled not to pay Initial and/or Variation Margin if the payment amount does not exceed RUB 100 million. Furthermore, the parties may reduce the said Minimum Transfer Amount.

### **Questions for Chapter 2**

3. Do you have any comments/suggestions regarding the classification of participants in the OTC derivative market for adoption of the requirement for mandatory margining of NCC derivatives? If so, please state them in detail.

4. Do you have any comments/suggestions regarding the criteria for assignment to a certain group for the purposes of adopting the requirement for mandatory margining of NCC derivatives? If so, please state them in detail.

5. Do you have any comments/suggestions regarding the list of persons who will not be covered by the mandatory margin requirement (certain entities)? If so, please state them in detail.

6. Do you have any comments/suggestions regarding the terms for phasing in the requirement for mandatory margining of NCC derivatives? If so, please state them in detail.

7. Do you have any comments/suggestions regarding the threshold values for the purposes of adopting the requirement for mandatory margining of NCC derivatives? If so, please state them in detail.

8. Do you find the rules set forth in Clause 2.3. for the Minimum Transfer Amount to be optimal? If not, please explain and suggest alternatives, if possible.

<sup>12</sup>Regulatory Margin Self-Disclosure Letter, ISDA, 30 June 2016.

[http://www.isda.org/publications/pdf/35345836\\_14\\_WGMR\\_Self\\_Disclosure\\_Letter\\_Template.pdf](http://www.isda.org/publications/pdf/35345836_14_WGMR_Self_Disclosure_Letter_Template.pdf).

## CHAPTER 3. REQUIREMENTS FOR THE CALCULATION AND TRANSFER OF INITIAL AND VARIATION MARGINS

Insofar as it concerns the procedure for calculating and transferring Initial and Variation Margin, the Bank of Russia proposes to comply with BCBS-IOSCO Standards.

### 3.1. Initial Margin

According to Clause 3(d) of the BCBS-IOSCO Standards, Initial Margin protects the parties to the derivative from the potential future exposure that could arise from future changes in the mark-to-market value of the derivative during the time it takes to close out and replace the position in the event that one or more counterparties default. Therefore, the amount of Initial Margin should reflect the size of the potential future exposure.

#### **3.1.1. Transfer Procedure and Calculation Period of Initial Margin**

The BCBS-IOSCO Standards provide for bilateral exchange of Initial Margin — upon executing a transaction, each of the parties to the derivative should transfer Initial Margin to the other party. However, in cases when a participant covered by the requirement for mandatory payment of Initial Margin bears zero credit exposure in respect of its counterparty under the NCC derivative, such participant is not obliged to demand that its counterparty provide Initial Margin (unilateral provision). Such situations may occur in transactions where one of the parties fully discharges its obligations under the derivative on the date of the transaction. An example would be a call option on shares, executed on condition of payment of the full value

of the option by the purchaser on the execution date. The buyer of the option is not obliged to pay Initial Margin on this instrument, as the seller of the option does not bear the risk of the buyer's default on its obligations thereunder.

As regards the terms of calculation, it is proposed that a requirement be introduced for Initial Margin calculation under individual contracts or under a portfolio within no more than two business days from any of the following dates:

- a) the date of conclusion of a new NCC derivative or its addition to the portfolio;
- b) the expiry date of the NCC derivative or the date of its removal from the portfolio;
- c) the date of payment or delivery under the NCC derivative, not including payment or receipt of margin;
- d) the date of a change in the derivative maturity date<sup>13</sup> followed by the change in the amount of required margin (if the standard calculation model is used);
- e) no calculation of Initial Margin in the preceding ten business days.

It is also proposed that the deadline for Initial Margin payment be set no later than the business day following the day of Initial Margin calculation.

#### **3.1.2. Initial Margin Calculation**

Element 5 of the BCBS-IOSCO Standards indicates the need to calculate Initial Margin on a gross basis, as the collateral may not suffice to secure each of the parties with a large scope of mutual exposures under the derivatives executed between them, in the event of a default on obliga-

<sup>13</sup>Please refer to Table 4.

Table 4

## Initial Margin rates

Category of derivatives (depending on the underlying asset)	Initial Margin Requirement (% of notional exposure)
Credit derivatives (0–2 year residual maturity)	2
Credit derivatives (2–5 year residual maturity)	5
Credit derivatives (over 5 year residual maturity)	10
Commodity derivatives	15
Equity derivatives	15
FX derivatives	6
Interest rate derivatives (0–2 year residual maturity)	1
Interest rate derivatives (2–5 year residual maturity)	2
Interest rate derivatives (5 year residual maturity)	4
Other derivatives	15

tions by one of the parties. This means that Initial Margin shall be calculated not for the net obligation arising as a result of offsetting the mutual obligations of the parties to the derivative, but for the gross obligations of each party to the derivative. Therefore, if, as a result of executing several derivatives between Party A and Party B, Party A is to transfer to Party B an Initial Margin of RUB 10 billion under the portfolio, and Party B is to transfer to Party A an Initial Margin of RUB 8 billion under the portfolio, each of the parties shall transfer the above-mentioned amount to the other party. Transfer of a net amount of RUB 2 billion by Party A to Party B is not allowed.

To determine the Initial Margin amounts, the BCBS-IOSCO Standards prescribe using calculations based on historical data that incorporates periods of stress scenarios, with a 99 per cent<sup>14</sup> confidence interval over a 10-day horizon<sup>15</sup>. In the Bank of Russia's opinion, a 10-day horizon will be optimal for NCC derivatives on the condition that

Variation Margin is exchanged between the parties at least on a daily basis (Clause 3.2.1. hereof).

The Initial Margin level according to BCBS-IOSCO Standards may be calculated based on either the Standardised Margin Model or the Quantitative Portfolio Margin Model.

### Standardised Margin Model

Table 4 shows the Initial Margin rates determined subject to the underlying asset of the derivative. If there is a legally enforceable netting agreement that covers derivatives<sup>16</sup> for which Initial Margin is to be paid, the gross amount of Initial Margin calculated under the Standardised Margin Model may be additionally adjusted by the net-to-gross ratio calculated using the following formula:

$$\text{Net-to-gross ratio}^{17} = \frac{\text{net replacement cost for the derivatives subject to netting agreement}}{\text{gross replacement cost for the abovementioned derivatives}}$$

<sup>14</sup>A per cent probability (confidence interval) is used to calculate the expected maximum adverse deviation in the price of the collateralised obligation specified in the derivative from its market value within a time horizon.

<sup>15</sup>The time horizon is the period of time from the date of the last collateral exchange under a portfolio of non-centrally cleared derivatives settled with a defaulting counterparty to the date of closing out the positions on the said portfolio and hedging the market exposure.

<sup>16</sup>Netting agreement should comply with the requirements of Article 4.1 of the Law on Bankruptcy.

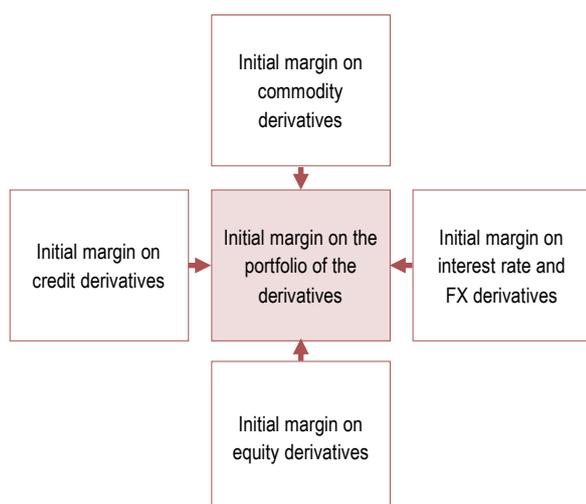
<sup>17</sup>Detailed information on this ratio and on the Initial Margin calculation formula based on that ratio is given in Clause 3.6 of the BCBS-IOSCO Standards and in Clause 5.1 of Annex 3 to Instruction 139-I.

### Quantitative Portfolio Margin Model

According to the quantitative portfolio margin model, Initial Margin is calculated on a portfolio basis. This model may apply only to a portfolio of derivatives, that are subject to the same legally enforceable netting agreement. According to the BCBS-IOSCO Standards, Initial Margin shall first be calculated for a group of derivatives with the same type of underlying asset (with a commensurable scope of risks), and then the Initial Margin amounts for each separate group of derivatives with the same type of underlying asset are summed up, thus forming a total Initial Margin amount for the portfolio (Figure 1).

Figure 1

#### Initial Margin calculation for the portfolio



According to Clause 3.3 of the BCBS-IOSCO Standards, the following rules apply to the quantitative portfolio margin model:

- A quantitative portfolio margin model shall be approved by the regulator.
- A quantitative portfolio margin model may be either internally developed or sourced from counterparties or third-party organizations.
- A quantitative portfolio margin model is subject to internal control and assessment by the institution using it.

In the opinion of the Bank of Russia, the DB should become the main developer of the corresponding quantitative portfolio margin models. In global practice, ISDA has become the developer of one of the corresponding models, called the Standard Initial Margin Model, or SIMM<sup>18</sup>.

With respect to Initial Margin, the BCBS-IOSCO

### 3.1.3. Initial Margin Disposal and Segregation

Standards establish a limited list of cases when the collecting party is entitled to dispose of property posted as Initial Margin. The said limitations come from the underlying rules for Initial Margin, as set forth in the BCBS-IOSCO Standards:

a) Initial Margin collected should be immediately available to the collecting party in the event of the counterparty's default.

b) Initial Margin collected must be subject to protection to the maximum extent possible under applicable law in the event that the collecting party enters bankruptcy.

For example, at the present time the European Union and the USA adopt a conservative approach and prohibit the disposition of Initial Margin received, except when Initial Margin received in cash is reinvested by a third-party custodian of the collateral asset in a different form of collateral. This approach is based on the possibility of additional risk occurring if third-party claims to the collateral property arise. Furthermore, legal and operational difficulties may delay or prevent the return of the collateral in the event of a default of the collateral taker or a third party.

Until recently, Russian law did not allow a pledge holder to dispose of the object of pledge, except when the object of pledge includes the rights of claim to money in a bank account, and the pledge holder is the bank where such collateral account is opened (Articles 358.9–358.14 of the CC RF)<sup>19</sup>. With the appearance of Clause 5, Article

<sup>18</sup>Regulation <http://www2.isda.org/wgmr-implementation>

<sup>19</sup>According to Clause 2, Article 845 of the CC RF, a bank may use money available on an account but must guarantee the client's right to freely dispose of these funds.

51.6 of the Law on the Securities Market<sup>20</sup>, the situation with regard to pledges has changed. According to that clause, a person in whose favour an encumbrance is imposed cannot be given the right to dispose of the securities on which such encumbrance is imposed, including the right to demand from the issuer or entity obliged under the securities to repurchase, acquire, or redeem these securities, except as otherwise established by federal law or contract. Thus, in their pledge contract the parties may establish the right of the pledgee to dispose of securities. The application of Clause 5, Article 51.6 of the Law on the Securities Market in margining of NCC derivatives might cause disputes in practice. For example, Russian laws do not establish a criterion for equivalent replacement of pledged securities by the pledgee in the event of their alienation by the latter before the grounds for their enforced seizure occur and the pledgee's obligation to return the same or equivalent securities before the secured obligation matures. It should be noted that these issues were fixed in the European Union by Articles 2 and 5 of Directive 2002/47/EC, respectively.

In general, the appearance in Russian law of the pledgee's right to dispose of pledged securities is consistent with the global practice regarding financial collateral. In the event that the title transfer collateral is used, where the ownership of the asset is transferred to a person the obligations to whom are secured, such person shall be free in disposing of such asset, unless otherwise established in the contract.

In the opinion of the Bank of Russia, the Initial Margin taker and a third-party custodian of the collateral shall have a limited possibility under the contractual documents to dispose of the Initial Margin received. Furthermore, a third-party custodian of the collateral shall be able to reinvest the Initial Margin in the assets that may be transferred as the Initial Margin, according to the list provided in Chapter 4.

According to BCBS-IOSCO Standards, assets comprising the Initial Margin should be duly segregated in order to mitigate the risks of the party transferring the Initial Margin.

According to the European and the US rules, Initial Margin must be segregated from other property of the collecting party and of the third-party custodian, if any, both at the level of contractual documentation and at the level of the relevant internal books of the collecting party and the third-party custodian. Moreover, in some cases foreign regulators require that Initial Margin be held only with a third-party custodian that is not affiliated with any of the parties to the derivative<sup>21</sup>.

Furthermore, according to the BCBS-IOSCO Standards, the party collecting Initial Margin and the third-party custodian must provide the party posting Initial Margin the possibility of holding Initial Margin separately from other customers and counterparties (individual segregation).

## 3.2. Variation Margin

According to Clause 3(c) of the BCBS-IOSCO Standards, Variation Margin protects the parties from the current exposure that has already been incurred by one of the parties to the derivative from changes in the mark-to-market value of the derivative after the transaction has been executed. Accordingly, the amount of Variation Margin should reflect the size of this current exposure and can therefore change over time.

### **3.2.1. Transfer Procedure and Calculation Period of Variation Margin**

Variation Margin shall be paid unilaterally to the party to a derivative indicated by the results of market revaluation of the positions under an individual contract or under a portfolio. Thus, Variation

<sup>20</sup>Article 51.6 was introduced by Federal Law No. 210-FZ dated 29 June 2015, 'On Amending Certain Legislative Acts of the Russian Federation and Invalidating Certain Provisions of the Legislative Acts of the Russian Federation'.

<sup>21</sup>E.g., the European Union and United States.

Margin shall be paid only by the party to a derivative which is a net debtor under the individual contract or under the portfolio at the time of payment of the Variation Margin.

It is suggested that a requirement be established for calculation of Variation Margin on at least a daily basis and its payment by the end of the business day following the Variation Margin calculation day.

### 3.2.2. Calculation of Variation Margin

Variation Margin shall be calculated by the parties to a derivative in accordance with the contracts executed between them. Furthermore, the Varia-

tion Margin amount shall fully collateralise the mark-to-market exposure. Since some NCC derivatives are not liquid enough, and there is no transparent pricing of such instruments, the parties should elaborate a detailed procedure for the settlement of disputes that may arise in respect of Variation Margin calculation before executing a transaction. In the opinion of the Bank of Russia, the DB may become the main developer of the corresponding rules, which would allow the market participants to effectively settle their disagreements regarding calculation and timely transfer of Variation Margin. At the international level, such standard documents are developed by ISDA<sup>22</sup>.

#### Questions for Chapter 3

9. Do you think a 99% confidence interval and 10-day horizon are good parameters for calculation of Initial Margin for the Russian NCC derivatives market? If not, explain why, and suggest and substantiate alternatives, if possible.

10. Do you have any comments on the suggested transfer procedure and calculation periods for Initial and Variation Margins? If so, please state them in detail.

11. Is it necessary to limit the scope of persons entitled to develop and apply their own quantitative portfolio margin models for Initial Margin calculation? If yes, what requirements should apply to such persons?

12. What procedure for custody of Initial Margin do you find optimal: a) collateral can be held only with a third-party custodian; b) collateral can be held with a third-party custodian and with the Initial Margin taker? What requirements should apply to third-party custodians?

13. Should a pledge and/or other legal device be used to ensure adequate protection of the Initial Margin against insolvency of its taker?

14. Do you find it expedient to harmonise the methods for calculation of Initial and Variation Margins used in the central clearing of derivatives and for NCC derivatives?

<sup>22</sup>As an example of a standardised procedure for settling disagreements on the calculation of Variation Margin, consider paragraph 4 in the ISDA 2016 Credit Support Annex for Variation Margin (VM) (Title Transfer — English Law).

## CHAPTER 4. REQUIREMENTS FOR ASSETS TRANSFERRED AS INITIAL AND VARIATION MARGINS

In global practice, requirements for assets that constitute collateral are among the most important requirements applicable to NCC derivatives.

Based on the BCBS-IOSCO Standards, the Bank of Russia suggests proceeding from the following parameters for choosing assets for margining:

- high liquidity;
- capacity to retain value during financial stress, subject to the application of appropriate haircuts;
- resistance of the asset to excessive credit, market, and currency risks;
- proper diversification of assets, including minimization of concentration on a particular issuer or class of issuers or class of assets;
- inadmissibility of securities issued by the counterparty or its affiliates as collateral<sup>23</sup>.

The Bank of Russia suggests considering the following types of assets as appropriate for margining:

- Rubles and the following foreign currencies: euros, US dollars, pounds sterling, Japanese yens and Swiss francs;
- gold in bars in vaults and on banks' accounts;
- securities issued by states, national central banks, and organisations which have been authorised under the law of the respective countries to make borrowings on behalf of the state; international financial institutions and international development banks specified in 2.3.1 of Clause 2.3 of Instruction 139-I (hereinafter, 'Public Securities');
- debt securities of other issuers (with a credit rating of debt securities issue (issuer)) no less than the level established by the Bank of Russia Board of Directors: for Russian objects of rating — assigned according to the national rating scale for the Russian Federation by credit

rating agencies included by the Bank of Russia in the list of credit rating agencies; for foreign objects of rating — assigned according to the international rating scale by foreign credit rating agencies (hereinafter, 'Private Securities');

- equity securities included in the lists for calculating the MICEX Index and/or the RTS Index, as well as the following stock indices (hereinafter referred collectively as 'Equity Securities'):

1. ASX 100 (Australia);
2. S&P/Toronto Stock Exchange 60 Index (Canada);
3. Shenzhen Stock Exchange Component Stock Index (China);
4. CAC 40 (France);
5. DAX 30 (Germany);
6. NIKKEI 225 (Japan);
7. KOSPI 100 (South Korea);
8. FTSE 100 (Great Britain);
9. Dow Jones Industrial Average (USA).

Evaluation of an asset included in the Initial or Variation Margin provided by a counterparty is important for the future stability of the organisation, as the quality of such evaluation affects the level of the counterparty's credit risk. Therefore, assets chosen as margin collateral shall be subject to appropriate haircuts reflecting the reliability of a particular asset.

The BCBS-IOSCO Standards establish that assets accepted as margin collateral which meet all applicable requirements should not be exposed to excessive credit, market, and FX risk (including through differences between the currency of the collateral asset and the currency of settlement). Therefore, calculation of the haircut rate should

<sup>23</sup>This principle does not apply to the Bank of Russia's bonds.

Table 5

**Calculation of a haircut under a standardised model**

Type of asset	Term to maturity (early redemption)	Haircut (%)	
		Public securities	Private securities
Debt securities	up to 1 year	0.5	1.0
	1 year to 5 years	2.0	4.0
	over 5 years	4.0	8.0
	up to 1 year	1.0	2.0
	1 year to 5 years	3.0	6.0
	over 5 years	6.0	12.0
	any	15.0	inadmissible asset
Equity Securities		50.0	
Gold in bars in vaults and on banks' accounts		15.0	
Cash funds in the currency of settlements		0	

take into account the impact of the respective risk on the asset.

A haircut may be calculated using either a standardised model based on the standardised haircuts indicated in Table 5 or a quantitative model.

**Standardised model**

The Bank of Russia also suggests setting a requirement for an additional haircut of 8%, which would apply upon occurrence of currency risk if the currency of the cash asset provided as margin and the currency of settlements under the NCC derivatives are different.

**Quantitative model**

The quantitative model shall be based on the following principles:

- the haircut should be calculated subject to the market exposure level of the asset provided for margining;
- haircut calculation should be calibrated to a lengthy historical period of time, including at least one stress period, to calculate the coverage of a potential decline in the value of the asset provided for margining;
- in the opinion of the Bank of Russia, the DB may become the main developer of the relevant quantitative models for haircut calculation. Quantitative models must be approved by the Bank of Russia.

**Questions for Chapter 4**

15. Do you have any comments or proposals on the suggested types of assets for margining? If so, please state them in detail.

16. Do you have any comments or proposals on the haircut rates given in Table 5? If so, please state them in detail.

## CHAPTER 5. LEGAL FRAMEWORK OF MARGINING

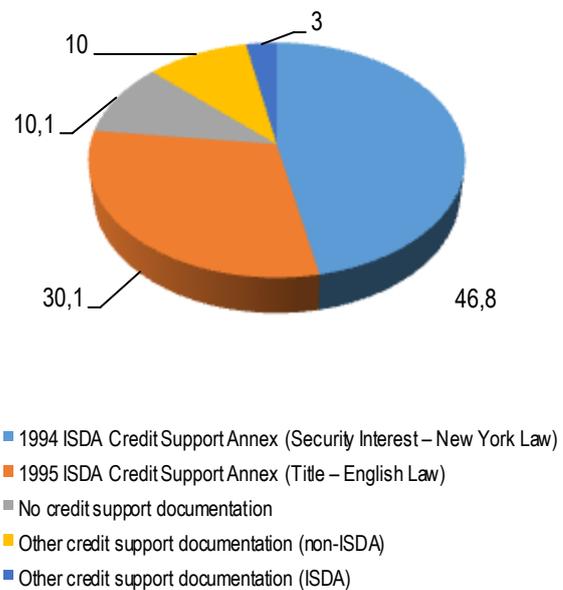
There are two main legal devices in international practice which are used for margining of NCC derivatives: collateral with the transfer of the full scope of rights to the collateral asset to the collateral taker (hereinafter, the 'Title Transfer Collateral') and collateral where a security interest in the collateral asset is obtained by the collateral taker, while full ownership of the collateral asset remains with the collateral provider (hereinafter, the 'Pledge'). Division of financial collateral into Title Transfer Collateral and Pledge can be seen, inter alia, in Directive 2002/47/EC. The contractual practice for derivatives based on standard forms of contracts developed by ISDA has also adopted both legal frameworks mentioned above. ISDA, whose form for a master agreement for transactions with derivatives is used in one version or another in over 90% of international transactions with OTC derivatives<sup>24</sup>, has developed packages of standard documents (hereinafter, 'ISDA Credit Support Documentation') used for margining of OTC derivatives by using the benefits of Title Transfer Collateral and Pledge<sup>25</sup>.

ISDA credit support documentation under English Law and New York Law, regardless of the legal framework used, usually has the following common attributes:

- ISDA agreements are bilateral, which means that each of the parties may act as a collateral taker and as a collateral provider;
- the collateral is provided by way of transferring the property (title) from one party to the other

Figure 2

Statistical data on the use of credit support documentation\*



\*ISDA Margin Survey 2015

<http://www2.isda.org/attachment/Nzc4MQ==/Margin%20survey%202015%20FINAL.pdf>

party; however, the services of a third-party custodian, who holds custody of the collateral, may be used;

- the collateral is revalued periodically based on the market value of the assets provided as collateral (therefore, the legal device should allow for the prompt substitution and/or supplementation of the provided collateral).

For the purpose of margining of NCC derivatives under Russian law, the following legal devices may be currently used, in the opinion of the

<sup>24</sup>This argument was used in the legal proceedings in England during the insolvency of the financial group Lehman Brothers: <https://www2.isda.org/attachment/NDMxMA==/ISDA%20Firth%20Rixson%20Appeal%20First%20Submission.pdf>.

<sup>25</sup>See, for example, ISDA 2014 Standard Credit Support Annex (Transfer — English Law), ISDA 2016 Credit Support Annex for Variation Margin (VM) (Title Transfer — English Law) (based on the device of Title Transfer Collateral); 2016 Phase One IM Credit Support Deed (Security Interest — English Law), ISDA 2016 Phase One Credit Support Annex for Initial Margin (IM) (Security Interest — New York Law) (based on the device of Pledge).

Bank of Russia: Pledge<sup>26</sup>, Standard terms of the agreement on the procedure for paying floating margin amounts<sup>27</sup>, and security payment<sup>28</sup>.

## 5.1. Pledge (Security Interest)

Pledge is typical of the Russian legal system and well-regulated. The general rules on Pledge are set forth in the CC RF, and special rules related to the pledge of non-certificated securities and immobilized certificated securities are set forth in Article 51.6 of the Law on the Securities Market.

At the same time, Pledge has certain deficiencies for use with respect to derivatives.

Enforced seizure of pledged property under Russian law is a rather lengthy process with the following barriers:

- Clause 8, Article 349 of the CC RF provides for a minimum 10-day period before the extrajudicial liquidation of the object of pledge may be started.
- Extrajudicial liquidation of the pledged property may be delayed or blocked intentionally by the pledger, with reference to Clause 3, Article 350.1 of the CC RF.
- The obligation of collateral creditors to wait for bankruptcy proceedings to satisfy their claims in the order of priority (according to the collateral procedure) in the course of bankruptcy proceedings, including because in the supervision

stage of bankruptcy proceedings set-off of claims against the debtor is forbidden, as a general rule<sup>29</sup>. Furthermore, in the event of the bankruptcy of a credit institution which is a pledger, the pledgees will bear the risk that the pledged property will be used in full to satisfy the claims of the primary and secondary creditors<sup>30</sup>.

Unlike Title Transfer Collateral, Pledge does not create a contractual right of claim against the pledgee for the return of the pledged asset or its equivalent value, which could be included in the calculation of a close-out amount. Therefore, the object of pledge is not involved in the close-out netting process, but may be used to pay the close-out amount arising from the close-out netting by selling the object of pledge. In the absence to date in the Russian OTC derivatives market of standard credit support documentation prepared under the pledge-based structure, the issue of the possibility and expediency of concluding a pledge agreement on the terms of a master agreement (single contract), as per Clause 1, Article 51.5 of the Law on the Securities Market, remains open.

It should be mentioned, however, that the possibility of using close-out netting in the Russian Federation for NCC derivatives has been confirmed, *inter alia*, by the international law firm Clifford Chance in its memorandum of law, prepared for ISDA in 2015<sup>31</sup>.

<sup>26</sup> Paragraph 3, Chapter 23 of the Civil Code of the Russian Federation.

<sup>27</sup> Standard terms of the agreement on the procedure for paying floating margin amounts constitute a composite part of standard documents for derivative transactions in the financial markets developed with the participation of three associations — the Association of Russian Banks, the National Financial Association, and the National Association of Stock Market Participants.  
[http://www.spfi.info/files/Standart\\_docs.pdf](http://www.spfi.info/files/Standart_docs.pdf)

<sup>28</sup> Paragraph 8, Chapter 23 of the CC RF.

<sup>29</sup> With regard to credit institutions, according to Subclause 4, Clause 4, Part 9 of Article 20 of the Law on Banks, after a credit institution's banking licence is revoked, unless otherwise stipulated in federal law, and until the effective date of the arbitration court's resolution on recognition of the credit institution as insolvent (bankrupt) or on its liquidation, it is prohibited, among other things, to terminate liabilities to the credit institution by way of offsetting mutual similar claims.

<sup>30</sup> Clause 4, Article 189.92 of the Law on Bankruptcy.

<sup>31</sup> Clifford Chance. Memorandum of Law for the International Swaps and Derivatives Association, Inc. on the Enforceability under Russian Law of the Close-out Netting Provisions under ISDA Master Agreements, 6 February 2015. This memorandum of law was updated on 12 January 2017.

## 5.2. Title Transfer Collateral (Floating Margin Amounts Model)

According to Clause 1, Article 329 of the CC RF, the fulfillment of obligations may be secured, apart from the methods established by law, in the manner prescribed by the contract. Besides, in accordance with Clause 1, Article 51.5 of the Law on the Securities Market, counterparties may conclude on the terms and conditions set forth in the master agreement (single contract) a contract that provides for the obligation of one of the counterparties thereto to transfer to the other party securities and/or money, including foreign currency, to secure the fulfillment of obligations arising out of contracts concluded on the terms and conditions of such master agreement (single contract).

Standard terms of the agreement on the procedure for paying floating margin amounts allow the parties thereto to exchange margin in the form of cash funds, on the terms and conditions set forth in a master agreement (single contract). Unlike Pledge, close-out netting is applicable to such floating margin amounts. However, Standard terms of the agreement on the procedure for paying floating margin amounts do not allow the parties to exchange other types of assets except money, and do not apply to the derivatives executed outside the framework of the master agreement (single contract). Besides, the tax laws do not currently establish a special taxation procedure for floating margin amounts.

## 5.3. Title Transfer Collateral (Security Payment Model)

Following the adoption of Federal Law No. 42-FZ dated 8 March 2015, 'On Amending Part One of the Civil Code of the Russian Federation', a new type of collateral appeared in Russian civil law — that is, a security payment. According to

Clause 1, Article 381.1 of the CC RF, a monetary obligation, including the obligation to compensate losses or to pay a penalty upon the violation of a contract, or an obligation arising on the grounds set forth in Clause 2, Article 1062 of the CC RF may be secured by agreement of the parties by transferring a certain amount of money by one party in favour of the other party (a security payment). Upon occurrence of the circumstances stipulated in the contract, the security payment amount is applied towards the fulfillment of the respective obligation. At the same time, a security payment in the form established in the CC RF has limited functionality. In particular, according to Article 381.2 of the CC RF, a security payment in the form of the transfer of securities cannot secure the fulfillment of any obligations other than the obligation to transfer those same securities.

Just as with floating margin amounts, the efficiency of extending the security payment on the derivatives executed outside the framework of the master agreement (single contract) is dubious. As mentioned above, set-off during the period of supervision in bankruptcy proceedings is limited from the Russian law perspective. In particular, according to Paragraph 7, Clause 1 of Article 63 of the Law on Bankruptcy, it is not allowed to terminate the debtor's monetary obligations by offsetting a counter-claim of the same kind, if such termination violates the order of satisfaction of creditors' claims, as established in Clause 4, Article 134 of the Law on Bankruptcy. Therefore, upon occurrence of the circumstances stipulated in the contract, set-off of the security payment amount towards the fulfillment of the secured obligation in accordance with Clause 1, Article 381.1 of the CC RF may appear to be impossible.

However, Paragraph 7, Clause 1 of Article 63 of the Law on Bankruptcy makes an exception for financial contracts (one of which may be a contract of security payment) executed on the terms and

conditions of a master agreement (single contract) in which case the amount of obligations is determined as per Article 4.1 of the Law on Bankruptcy<sup>32</sup>.

#### **Questions for Chapter 5**

17. Which legal device for the posting of Initial and Variation Margins do you find the most suitable? Explain your reasoning.

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<sup>32</sup>A similar exception is contained in Clause 7, Article 20 of the Law on Banks, insofar as it concerns revocation of a credit institution's banking licence.

## CHAPTER 6. SERVICES FOR THE CALCULATION, SELECTION, AND REVALUATION OF COLLATERAL AND STANDARDISATION OF DOCUMENTS

The calculation of Initial and Variation Margins to be posted and the selection of appropriate assets for margining may be assigned by one party to NCC derivatives to the other party or to a third party. Both parties to NCC derivatives may appoint a third party which will perform the said actions for both parties.

Because mandatory margining requirements for NCC derivatives are planned to cover not only professional securities market participants, but also financial market participants who do not have the necessary experience and expertise, the Bank of Russia points out the need to develop a segment of specialised services for the calculation, selection, and revaluation of collateral for NCC derivatives. In the international financial market, such services are usually provided by large infrastructural organisations<sup>33</sup>.

The services of collateral management in the Russian financial market are currently provided, for example, by the NSD<sup>34</sup>.

We also think that for the purpose of margining, it would be reasonable to develop the following standard documents under the aegis of the DB:

- standard forms, time frames, and procedures for disclosure by counterparties to NCC deriva-

tives of information on attainment of relevant threshold values, for the purpose of applying the mandatory margining requirement;

- standard credit support documentation under Russian law for the exchange of Initial and Variation Margins;
- rules for resolving disputes on the calculation and timely transfer of Variation Margin;
- models of calculation of Initial Margin;
- haircut calculation models with respect to assets accepted as margin.

Based on Recommendation 11 of the FSB Report 'Implementing OTC Derivatives Market Reforms,' the Bank of Russia also suggests preparing a legal framework for the development of compression services for portfolios of NCC derivatives and the implementation of modern risk management procedures by the entities, which are subject to the requirement for mandatory margining of NCC derivatives, in order to enhance the effectiveness of margining, reduce operational risk, and release the liquidity and capital of credit institutions.

### Questions for Chapter 6

18. Do you have any comments/proposals regarding the development of the services of calculation, selection, and revaluation of the collateral in Russia? If so, please state them in detail.

19. Do you have any comments/proposals regarding the standardisation of documents required for margining? If so, please state them in detail.

<sup>33</sup>Such as Clearstream (<http://www.clearstream.com>), Euroclear (<http://www.euroclear.com>), Trioptima (<http://www.trioptima.com/>).

<sup>34</sup>Currently such services are provided in respect of repo transactions only.

## CHAPTER 7. CROSS-BORDER TRANSACTIONS

The absence of sufficient uniformity in the international derivatives market, in terms of time frames and approaches to regulation of mandatory margining of NCC derivatives, gives rise to prerequisites for regulatory arbitrage and the risk of discrimination of financial market participants of one country against financial market participants of another country.

When resolving these issues, in the Bank of Russia's opinion, attention should be paid to the following areas:

- synchronisation of entry into force of the new regulation at the international level;
- improvement of the definition of derivatives and their types and bringing them in line with global practices;
- possible acknowledgement of the equivalence of foreign regulatory regimes.

The Bank of Russia plans to extend the rules of mandatory margining of NCC derivatives, as set forth herein, to NCC derivatives executed with foreign entities from Category 1 or Category 2, with due regard to the exceptions specified in Clause 2.2.2.

Mandatory margining requirements will not apply to contracts for obligations which are cleared through a foreign central counterparty.

If according to the *lex societatis* of a foreign entity, it is subject to a mandatory margining requirement, NCC derivatives with such a foreign entity shall be subject to mandatory margining based on the rules established by such *lex societatis*, provided that the state to which such *lex societatis* relates is on the list established by the Bank of Russia<sup>35</sup>.

Table 6 specifies the applicable rules, depending on the *lex societatis* of a foreign counterparty.

Table 6

Applicable margining rules for foreign counterparties

Party to the contract 1	Party to the contract 2	Applicable margining rules (including, but not limited to, the list of instruments and entities covered by the rules; amount and calculation procedure of threshold value)
A foreign entity, the <i>lex societatis</i> of which is the law of a state that is on the list of the Bank of Russia	A Russian entity	Foreign
A foreign entity, the <i>lex societatis</i> of which is the law of a state not on the list of the Bank of Russia	A Russian entity	Russian

### Questions for Chapter 7

20. Do you find the special rules for the regulation of cross-border transactions specified in this Chapter to be optimal? If not, please explain and suggest alternatives, if possible.

<sup>35</sup> Upon formation of the list, the status of implementation of the mandatory margining requirements in specific foreign states will be taken into account.

