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Russia - Derivatives Alert

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New OTC derivatives reporting regime

In August 2016 the Central Bank of the Russian Federation (the "**CBR**") passed a new regulation on reporting OTC derivatives and repo[1] transactions (the "**New Reporting Regulation**") which superseded the previous regulation passed by the CBR in 2014. The New Reporting Regulation was enacted to implement the changes to the Federal Law No. 39-FZ "On Securities Market" dated 22 April 1996 (as amended) (the "**Securities Market Law**") which had come into force on 28 June 2016 and had set out the status of the repository on a legislative level.

The New Reporting Regulation crystallises some existing requirements for reporting of information on OTC derivatives and repo trades and also introduces some new requirements.

For example, previously only trades entered into on the basis of a master agreement (e.g. RISDA, ISDA, GMRA) were subject to reporting to the repository. After coming into effect of the New Reporting Regulation, all trades which fall within the scope of reportable transactions such as option, swap, forward, repo transactions (including stand-alone trades) are subject to reporting.

Further, according to the New Reporting Regulation, an obligation to report trades is now imposed not only on professional financial institutions (e.g. banks, brokers, dealers, etc.) but in certain cases on corporates starting from 1 November 2016 (e.g. a trade between non-professional entities exceeding 1 billion roubles, app. US$16mln). Foreign counterparties are still not subject to the trade reporting obligation.

Close-out netting

On 4 July 2016 the close-out netting regime set out on the Federal Law of 26 October 2002 No. 127-FZ "On Insolvency (Bankruptcy)" (the "**Bankruptcy Law**") was improved (the "**Netting Amendments**"). Before the Netting Amendments came into force, submission of information on every trade to a repository had been a precondition to close-out netting under the Bankruptcy

[1] Directive of the Central Bank of the Russian Federation dated 16 August 2016 No.4104-U.

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Law. Accordingly, close-out netting could be unavailable to the parties or would otherwise be distorted due to technical inaccuracies in the repository records.

Under the Netting Amendments to ensure the recognition of trades for close-out netting purposes the parties need to report only the eligible master agreement (e.g. RISDA, ISDA, GMRA) which partially mitigates the netting disruption risks described above. Also, notwithstanding the fact that it is no longer needed to report information on every trade for the purposes of close-out netting, the parties which are subject to reporting obligations (e.g. banks, brokers, dealers and certain corporates) still have to make such reporting as a stand-alone obligation not connected with close-out netting eligibility.

Bank of Moscow case

The case involves two cross-currency swap transactions entered into in 2013 on the basis of 2011 RISDA master agreement between PJSC "BM-Bank" (formerly OJSC "Bank of Moscow", "**BM-Bank**") and LLC "Platinum Nedvizhimost" ("**PN**").

In 2016 PN demanded invalidation of both swap transactions and the master agreement when further performance of its obligations thereunder became burdensome due to poor economic climate.

The court upheld the position of PN and invalidated the transactions stating, among other things, that:

> BM-Bank, as a professional party, should have used necessary and sufficient efforts to explain to PN legal and economic substance of the swap transactions, their terms, possible consequences, financial risks and the worst-case scenario possible in a clear way understandable to any non-professional party unacquainted with relevant professional terminology and practices;

> BM-Bank failed to do so (approximate calculations and examples with a cover letter provided by BM-Bank were deemed insufficient) and, therefore, acted in bad faith and abused its rights;

> PN suffered from detrimental and unprofitable transactions due to unequal bargaining power;

> the terms of the transactions should be interpreted *contra proferentem*, i.e. against BM-Bank as a professional party.

As of today, the case withstood the cassation.

Collateral – two legislative models requiring further adjustments

In 2015 the Civil Code was amended and these amendments, among other things, introduced a new type of security arrangement under Russian law named "collateral payment" ("*obespechitel'nyj platezh*" in Russian) (the

"**Financial Collateral**"). Under new Articles 381.1 and 381.2 of the Civil Code, the debtor under the financial obligation (including obligations under enforceable derivative transactions) is allowed to pay money or transfer shares, bonds, other securities or generic things ("*veshhi, opredelennye rodovymi priznakami*" in Russian) as a Financial Collateral securing such monetary obligations, including future obligations and obligations to compensate losses and to pay the penalty ("*neustoika*" in Russian). The wording of the Civil Code is far from perfect from the point of view of the common CSA-type title transfer mechanics. The regulator is considering making some minimal amendments to these provisions of the Civil Code to make this new concept of Financial Collateral work better for OTC derivatives.

Federal Law of 29 July 2015 No. 210-FZ introduced certain changes to the Securities Market Law which recognise cash and securities collateral provided to support derivative and repo trades entered into under a master agreement that has a single agreement clause. This generic permission provides considerable flexibility in that it does not necessarily improve a particular collateral transfer model. Having said that, it is not entirely clear how this broad wording will interact with the Civil Code provisions on Financial Collateral and whether the latter can be effectively disapplied for the purposes of structuring a conventional collateral transfer model solely under the Securities Market Law. The regulator is currently considering amendments which may help to fix these uncertainties in the Civil Code and the Securities Market Law.

Although the Bankruptcy Law has not been changed yet to specifically refer to such financial collateral, the Securities Market Law amendment is worded in a way which suggests that CSA-type collateral should be eligible for close-out netting effected in respect of the trades made under the same master agreement. Having said that, the risk that collateral arrangement itself could be challenged based on the common insolvency law clawback grounds (such as preference) still remains and it is understood that the CBR proposes to further amend the Bankruptcy Law to fix this.

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