

Clearing activity development

Clearing activity implicates management of risks connected with the transaction settlement organization and control of settlements realization between every transaction subjects by specialized structure. It is obvious that clearing on organized financial market should be exercised on the basis of effective and convenient for clients service system.

To divide exchange and clearing activity, in the currency market, in the first place, in the network of the MICEX Group during the analyzed period was created a bank which specializes on clearing activity – closed joint-stock company JSCB “National Clearing Center” (further NCC)¹. License of the Bank of Russia allows to NCC a number of necessary for clearing activity options (including crediting), also in the securities market. In perspective NCC will be able to perform functions of a central counterparty, thus allowing to form on MICEX the system of conclusion, clearing and execution of transactions. As it is known an institute of central counterparty on transactions (Central Counterparty, CPP) is successfully used by all world’s leading exchanges. But the MICEX exchange itself may not independently perform this function in the currency market, because according to Russian legislation only banks have the right for currency transactions.

Clearing participants must be permitted to use their resources, intended both for participation in tender and for clearing results settlements, more efficiently. Because of implementation of risk management and usage of settlement organization mechanisms, based on opportunities provided to NCC by the bank license, the following opportunities will be given for clearing participants on the currency market in near future:

¹ Utkin V. “Clearing on results of MICEX tender results will be made by a specially created bank” // Exchange review. 2007. No. 11(49). November.

- opening of unified position (they may be used on different markets) on rubles and basic currencies for clearing participants, used for clearing results settlement;
- transactions on the basis of both full and partial collateral;
- efficient usage of funds contributed as collateral and/or for performing of clearing results settlements on different markets;
- crediting of participants by funds and/or securities with the aim of discharge of obligations provision by them;
- opening and administration of banking accounts for artificial persons;
- provision of banking services to clearing participants for effective liquidity management.²

Transferring of MICEX currency market clearing to NCC is supported by the Bank of Russia, as currently, only 15-17 % of the total exchange transactions volume comes on its organized part. Though market volumes increase, the correlation between exchange market and over-the-counter segments is almost stationary. It is supposed that passing to the new clearing and settlement scheme, implementation of additional services in these areas will contribute to growth of exchange trades share in Russian market.

Besides, together with the Bank of Russia NCC in 2007 started the project on formation of exchange trading sector in the market of repo transactions with state securities, where NCC will perform the role of clearing center, at the time fulfilling functions of the central counterparty. Repo transactions will be concluded on the basis of double continuous auction, and one party of every transaction will always be NCC in order to provide clearing and settlements. As this financial market segment is referred to the Bank of Russia, in fact (by means of participation in MICEX

² Ibid.

capital) controlling the NCC activity, there are no political obstacles for appropriate alteration of its normative base, thus creating certain competitive advantages in clearing development for the MICEX group in comparison with RTS.

Besides the Board of Directors of MICEX and the Bank of Russia decided to additionally increase reliability of the new clearing scheme by provision from MICEX to NCC of additional guarantees to the sum of 100 million dollars. As in accordance with supposed settlement model NCC will act as the central counterparty and will become a party of each concluded transaction, than the necessity in NCC capitalization will increase. The enquiry is that NCC has sufficient capital (700 million rub.) to service MICEX currency market according to existing settlement model, is not sufficiently capitalized to perform the central counterparty function, but traders shall fix limits regarding to NCC in this case, as on the second transactions party.

Subject of Central counterparty is actively developed on the RTS exchange either. Its experts proceed from that trading technologies without centralized clearing are usually used for less liquidity securities or specific segments, for example for foreign securities trading.³

An entrance in the organized market without central counterparty may become much more complicated for participants which apply the policy “Know Your Customer” (KYC) and procedures of anti-money laundering (AML). On markets, which do not use the central counterparty, transactions are made directly between trade participants, and it means that each trade participant must be ready to make transactions with any other participant. With the large number of participants the preliminary check of all participants is almost impossible, and that is why only those

³ Sugorukov A. “Securities market infrastructure comes to a next level – with the central counterparty” // Securities market. 2007. No. 21(348). November.

participants are admitted there which were checked by regulator, which brings KYC/AML requirements.

In spite of its relative youth, Russian financial market has already coped with the technology of trading with the central counterparty on the forward market. On the forward contracts exchange the necessity of usage of clearing organization as a party for all transactions follows from, at least, the nature of corresponding instruments. So, for example, for the FORTS market – the biggest Russian forward market, - such central party for transactions for several years is a closed joint-stock company “RTS clearing center”. However, in that case it was possible to make it also because of the lack of distinct forward market regulation, and because of ambiguity of its legal nature in whole, from the point of view of legal doctrine accepted in Russia. For Russian securities market the central counterparty had not been used for any trading place because it is not even mentioned in the part of clearing activity description of securities market legislation.

It would be relevant to mention that settlement anonymity and presence of clearing center on organized markets with a 100% preliminary deposition doesn't mean that all transactions are made with the usage of central counterparty institute. Legally each transaction on such markets is made between two its participants. Hundred-per-cent deposition considered to be so much secure that the exchange may just not disclose the counterparty, and the broker's back office may mark the exchange in its system as a counterparty for each transaction (because it is needed to indicate someone). There are not so many experts understanding the essence of problems existing in the market, and nobody of them is interested in raising noise, consequences of which may be too much unpredictable (especially if to think of the RF Civil code, which doesn't

allow transactions in case of coincidence of buyers and sellers, and even more, requires to make transactions between legal entities only in writing)⁴.

Nevertheless, it would be unacceptable from the regulatory point of view to use the central counterparty technology on securities market on default. Therefore, after consideration of all possible ways of centralized clearing on RTS was chosen the principle, according to which the central counterparty becomes a transaction party directly at the moment of its conclusion, which is provided also by the bill under drafting “About clearing and clearing activity”. Chosen legal scheme is simple enough: claim of each participant, given to the exchange trading system is considered to be an offer to the counterparty, which will accept it only when there is cross claim in the waiting list with the same or better price. So, the central counterparty concludes two transactions simultaneously with each participant, given cross claims. To fully correspond with the same RF Civil code, offers and accepts are signed by the autograph signature analog.

According to RTS experts this suggested clearing and settlement model allows to build a trading technology, which fully corresponds to modern international standards on the one hand and to all active securities market legislative norms – from the other hand. Though the last statement seems to be arguable, but it is obvious that even if both cross claims were given by a single exchange trade participant at the expense of different clients, there is no coincidence of seller and buyer in a single transaction any more. There are two transactions and in each of them the participant is only one party. RTS plans to implement the principle of trading with the central counterparty for their securities markets, using continuous double auction of cross claims – in Trading regime with full collateral and in Electronic trade regime (also known as anonymous trade)⁵.

⁴ Ibid.

⁵ Ibid.

Besides, because one party of all transaction now will be always known, - NP RTS, performing in the RTS Group the role of clearing center on securities transaction – RTS gained an opportunity to use changes in exchange regulation, videlicet to allow in the network of anonymous trade:

- clients-residents registration;
- clients registration according to commission scheme (when transactions are concluded at the expense of clients, but in the name of trade participant);
- dealer's transactions conclusion (transactions at the expense of trade participants).

Money settlement procedure is built so, that there are no remittance in USA dollars between accounts of two residents. That is to say that trading participants may use the RTS anonymous trading segment almost without any limitations as a full-fledged exchange, including provision to their clients of services for direct access in the market.

It significant to mention that the application of the central counterparty institute and admission of residents to the delivery versus payment system with settlements in USA dollars will not require broker's back offices work reorganization. All changes are concentrated on the side of trade and settlement complex of the RTS Group – in internal documents and software. The usage of netting procedure is not planned for now.

In whole, it may be noticed that the competition of two main Russian trading places – MICEX and RTS – fruitfully affects on clearing activity development. At the lack of full-fledged normative base this development has an initiative character. From the point of legal basis of existing developments, MICEX, relying on the Bank of Russia regulatory support has some advantage. From the other hand FFMS does not interfere to the clearing development on the RTS forward market, by accepting on default the ambiguity of legal situation and the necessity of development of risk management mechanisms in the derivatives market.