



Amendments to Russian regulation on securities and derivatives trading

This briefing discusses changes made to the regulation on securities and derivatives trading in Russia. The amendments to Federal Law No. 39-FZ dated 22 April 1996 'On Securities Market' (the Securities Market Act), Tax Code of the Russian Federation (the Tax Code) and certain other laws were signed into law on 25 November 2009 (the Amendments) and, except for certain provisions, will become effective on 1 January 2010. In particular, the Amendments extend the regulation of trading in derivatives, introduce the concept of a repurchase transaction and provide for some new rules on tax treatment of such financial instruments.

Securities Market Act

New definitions of financial instruments and derivatives

The Amendments introduce a definition of a 'financial instrument' (*finansovy instrument*) which includes both securities and derivatives. Further, a new definition of a 'derivative' (*proizvodny finansovy instrument*) has replaced the previous concept of 'other [in addition to the securities] financial instruments', which appeared in the Securities Market Act for the first time at the end of 2007. The repurchase transactions (REPOs) are specifically excluded from the notion of a derivative under the Amendments. It is not clear whether 'foreign financial instruments', a concept introduced by the changes of the Securities Market Act in effect from May 2009, would be caught by the new definitions and thus be subject to the new rules.

Under the amended Securities Market Act the definition of a derivative covers three groups of instruments, each of which in turn embraces a wide range of products:

- a agreements providing for a party's, or the parties', obligation to make payments once or periodically, including upon a demand by the other party, based on:
 - i the changes of prices for commodities, securities, currency exchange rates, interest rates, inflation levels, indices based on the prices of derivative contracts, official statistics data, environmental physical, biological or chemical indices, credit events of one or more legal entities, governmental

or municipal authorities (except that suretyship and insurance agreements are not viewed as derivatives);

- ii other circumstances, the occurrence of which is uncertain and which are specified in a federal law or regulation of the Federal Service for Financial Markets (the FSFM); and
 - iii the changes of indices calculated on the basis of one or more of such factors. Such agreements may provide for delivery of the underlying securities, commodity or currency or the obligation to enter into a derivative contract;
- b options to sell or purchase securities, currencies or commodities, as well as to enter into a derivative contract; and
 - c agreements that both (i) provide for the obligation of one party to transfer title to securities, currency or commodity not earlier than the third day after entering into the relevant agreement with the obligation of another party to accept and pay for the relevant asset; and (ii) designate such agreement as a derivative.

The new definition is more extensive than that in the old rules on 'other financial instruments'. However, it is still not sufficiently clear and requires clarification from the FSFM, which has now been granted substantial regulatory powers with respect to derivatives trading.

The amended Securities Market Act introduces new types of underlyings for derivatives. At a first glance, these should be viewed as eligible underlying assets for the purposes of the safe harbour from the anti-gaming

rules provided for by article 1062 of the Russian Civil Code with respect to certain derivatives transactions. Such underlyings include indices based on the prices of derivatives contracts, official statistics data, environmental physical, biological or chemical indices and credit events. Unfortunately, the Amendments do not expressly specify that the derivatives with these newly added underlyings would enjoy judicial protection under article 1062 which leaves room for interpretation by courts.

New concept of REPOs

The Amendments have introduced to the Securities Market Act a uniform definition of a REPO applicable for private law, regulatory and taxation purposes. The previous definition of a REPO given in the Tax Code is now eliminated and substituted by the reference to the new definition in the Securities Market Act. Under the new definition, a REPO is an agreement under which one party (the seller) undertakes to transfer certain securities into the ownership of another party (the purchaser) and the latter undertakes to accept them and pay an agreed amount of funds (the first leg of a REPO). Within the agreed period thereafter the purchaser undertakes to transfer the securities into the ownership of the seller and the latter undertakes to accept them and pay an agreed amount of funds (the second leg of a REPO).

The provisions of the Russian Civil Code on the sale and purchase of goods will apply to REPOs by default, unless they are contrary to the provisions on REPOs of the Securities Market Act or the essence of the relevant REPO arrangement. This novelty should eliminate the risk of the recharacterisation of REPOs into a secured lending arrangement.

Securities that may be sold and purchased under REPOs include shares, bonds, options and Russian depository receipts issued by Russian entities, units of unit investment funds managed by Russian asset managers, shares and bonds of foreign issuers, and foreign securities representing Russian or foreign securities.

Apart from the definition of a REPO, the Securities Market Act now contains a number of provisions and requirements on the essence of a REPO arrangement.

For more details, please refer to *New regulation on repurchase transactions (REPOs)*.

Derivatives master agreements and early termination

The Amendments specifically provide that the parties may enter into master agreements governing derivatives. Such master agreements may incorporate the terms of model provisions of derivatives agreements, published by the Russian self-regulated organisations in the securities market. Should a master agreement be entered into, it may specify grounds for an early termination of transactions covered by the master agreement and, if it does so, it must also establish a procedure for the calculation of the termination amount. This is a significant step towards the recognition of early termination and close-out provisions in this context. However, the Amendments still do not expressly provide that the calculation of a single termination amount with respect to a number of transactions will be recognised should one of the parties to the master agreement go bankrupt.

Derivatives and REPOs for qualified investors

The Amendments grant the FSFM powers to qualify and categorise derivatives, establish requirements on underlyings, and determine derivatives and REPOs designed for qualified investors only.

If a derivative is designed for qualified investors only, it may be entered into only by qualified investors through a broker, unless the investor is a qualified investor by operation of law or otherwise exempted from this rule by the FSFM.

The Amendments introduce restrictions on trading in credit derivatives, stipulating in particular that:

- a such transactions may only be entered into by legal entities;
- b the protection seller under an exchange-traded credit derivative must be a qualified investor; and
- c the protection seller under an over-the-counter (OTC) credit derivative must be a licensed broker, dealer or credit institution.

Tax Code

Significant changes have been made to the Tax Code with respect to the tax treatment of financial instruments. The key changes concern corporate income tax, value added tax (VAT) and individual income tax regime for trading in securities and derivatives; various issues of qualification, categorisation and recharacterisation of securities and

derivatives transactions for taxation purposes; rules on pricing of securities; tax treatment of securities lending which is generally similar to the treatment of REPOs; and others.

Other changes

An important change is made to Federal Law No. 395-1 dated 2 December 1990 'On Banks and Banking Activity' with respect to commodity derivatives for credit institutions. Following this change commodity derivatives are exempted from activities prohibited for credit institutions.

Changes have been made to various other laws, including those on non-state pension funds, investment funds, the Russian Central Bank and others, so as to bring them in line with the amendments to the Securities Market Act.

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