



Stock trading in Russia

Development of trade relations is helpful for financial market

In Russia, we try to create an institutional environment, says Mr Alexey Timofeev, NAUFOR Chairman, in order to improve education of retail investors, in a exclusive interview with the ANMI Journal

International Interview

1. Despite being a finance and career diplomat, you might have faced challenges as NAUFOR Chief. Would you like to share your experiences?

In the mid-90s, at the height of the market reforms, I was invited to the team of experts working on the formation of the Russian legislation on privatization, companies and financial markets. As a result, I was involved in the development of all basic financial market laws that were new for Russia in those times – the law on joint-stock companies, limited liability companies, on securities market and investment funds. The team of Russian and foreign consultants helped a newly-established authority Commission of Securities Market to develop not only laws, but also Commission regulations. At that time, a huge work was executed to build a regulatory system of the Russian financial market and it was a great privilege for any professional to participate in the process. As a consultant, I used to work with all teams of the Russian Securities Market Regulator by developing

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and supplementing regulation. Probably due to the fact that I was well known both among the regulator's officials and market participants, in the year 2005 I was invited to lead NAUFOR. Actually I continued doing in NAUFOR the same I used to do before for the state regulator – I had been always seeking for solutions interesting for both the state and the market. Thanks to our efforts NAUFOR became the most powerful lobby organization and a considerable driver for market development. At the same time, we developed NAUFOR as a self-regulatory organization, i.e. an organization responsible for regulation and supervision of itself and complementing thereby the governmental regulation and supervision.

2. NAUFOR is a leading self-regulatory organization that makes rules for its members, sets arbitration process and is able to enforce them successfully. What has been the driving force for this leadership and what are the immediate focus and strategies?

Today, NAUFOR is indeed the largest SRO on the stock market, which consists of nearly 250 companies – brokers, dealers, portfolio managers and

management companies of UIF. These make about one-third of the market industry. NAUFOR is a combination of a lobby organization, an organization rendering mainly consulting services to its members and a self-regulatory organization, i.e. an organization establishing rules for its members and exercising control over their observation. Our members are big and small companies, national companies and daughter companies of global banks, Moscow and regional companies. Different members of NAUFOR use different NAUFOR qualities to different extents.

As a lobby organization, during some years we had bitter disputes with the state regulator concerning requirements to the capital of companies and so we acted on behalf of small companies, but we succeeded only now, having developed a right approach to differentiating requirements to the capital together with the Central bank, leveling them down for companies, performing the most simple set of operations. A year ago, we were actively arguing about creation of the Central bank-based Russian mega-regulator, due to and notwithstanding its creation a lot of our fears were considered in the process of its creation and in its future activity. Some time ago, on the basis of NAUFOR propositions, the procedure for the issue of securities was radically simplified, allowing the opportunity for the simplified financing for the small companies, and now we discuss the reform in the information disclosure system. Recently, due to the long-term lobbying efforts of NAUFOR, Russian retail investors have got a favourable taxation norm for their securities market operations. We have initiated and are still participating in the development of the legislation on investment advisers. In collective investments we are now focused on creating a system of centralized allocation and redemption of UIF units, something like FundServ in the USA and BSE StAR MF in India.

As an SRO, NAUFOR has developed several standards. These are advisory in nature. It is not mandatory to be a member of the self-regulatory organization for investment companies to act in the Russian financial market. So it's difficult to insist on following our rules. But we often penalize or even exclude companies from NAUFOR. Sometimes we use the authority of NAUFOR to obtain the looked-for results from our members. For example, some time ago, we evaluated the terms of contracts with customers of five large retail brokers and discussed our findings. As a result of negotiations brokers changed their contracts conditions and made these safeguard the interests of clients. This, in turn, had an impact on the entire industry – all other companies used solutions that we have found. In the process of supervision, we as an SRO carry out at least 50 planned inspections a year, during which we assess compliance with regulations and our

own standards. Besides, we certainly carry out inspections on complaints of our members' clients.

Apart from usual activity standards for its members, NAUFOR has developed and supports the standard documentation for OTC derivatives, which is an adaptation of the ISDA documentation.

It is important that there is strong confidence in the NAUFOR, with regard to what we do as an organization representing very different organizations, but able to express the most general interests of the industry, be persistent, and which behave equally and judiciously to all its members.

3. NAUFOR has framed “Ideal Model of the Russian securities market for the long-term perspective”. What are its core propositions and how dynamic is it to accept continuous economic changes?

This is very interesting. We started developing the “Ideal Model” as soon as I came to NAUFOR – it was important for me to develop a plan, according to which NAUFOR could work in the subsequent years. For this purpose we tried to identify the main features of financial markets of different countries (including India), and to assess what contributed to the success of their development. At the same time, we developed criteria, according to which one could estimate the state and development of the domestic financial market. All this time we interacted with different government departments. At the last stage, when we were developing measures to be adopted for the development of the Russian market, the Government has declared creating an international financial center in Russia, and as it turned out that a lot of measures as well as the approach that we have proposed were included into the programme documents of the Government. So far, many measures have already been adopted. For example, we have a good exchange and settlement infrastructure. Other measures are still in the process of adoption. Here we are closely cooperating with the Working Group of the President to create the IFC.

The main idea of the Ideal Model was to create a strong domestic investor. Taking into consideration the state of the Russian stock market, we believed and do still believe that this is the main condition for the market development and its attractiveness for global investors. This problem has not been solved yet, but right now, notwithstanding some inconsistent efforts, it has become the basis and we will be able to witness the effect of these efforts soon.

4. NAUFOR has established itself as a strong SRO and considering the fact that NAUFOR is a member of IOSCO SRO Consultative Committee, what key elements would you suggest to other

developing economies for effective self-regulation?

NAUFOR is indeed an affiliate member of IOSCO and its committee of affiliate members. It is very important for us. Thus, we are able to see what happens to our colleagues; we use their experience and share our own. We have always appealed to the self-regulation model adopted in the USA, Canada and Japan. In these countries, the government strongly relies on self-regulation, giving great authority to the SRO and demanding that all investment companies must be members of the SRO. This model is very important for Russia for its own reasons – it allows making a step to regulation “principles-based”, vitally important for the financial market. It is quite difficult to implement it on the basis of the state bodies because of the Russian legal tradition. SROs suit better for this. During a discussion on creating the Central bank-based mega regulator, the role of the SROs was recognized as a part of this reform. SROs were thought to supplement the CB as a regulator by their regulative and supervising abilities that are more flexible

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and abstract. CB would act as a mega regulator, i.e. it would be responsible for all financial institutions, while SRO would keep specialization allowing for better focus on specific industries. Now, the draft of the law on SROs is being finalized and I do hope it will be adopted at the end of the year, so then the membership in the SRO will become mandatory for everyone except for banks, and so will be the regulation of SROs, and their role will increase.

Perhaps, all reasons that we take as guide, will be already useful for countries that face the same problems; but it will be even better to look at the experience of our solutions during some years to come.

5. In-line stock trading and brokerage systems are under continuous threat of cybercrimes. What precautions and preventive measures or the malware detection systems are mandated by the Regulator in Russia?

Frankly speaking, this is still not a great problem for Russia.

6. Strong corporate governance duly supplemented by Investor education and awareness is the key to development of the financial market. However,

International Interview



**The Government
has declared
creating an
international
financial center in
Russia**

achieving these has been a big challenge. Your comments.

I agree. In Russia, we try to create an institutional environment in order to improve education of retail investors. Our efforts on creating the industry of investment advisors are aimed precisely at that. However, until now the more important task was to convince people to enter the stock market. If there is lack of financial instruments and their yield is lower than on alternative investments, no financial literacy will help. There are nearly 1 million retail investors – clients of brokers and nearly 1 to 1.5 million individuals – UIF unitholders. This is very little. The rest prefer bank deposits and real estate. Recently we significantly changed the tax rules. From the year 2014, the income from the 3-year investments in securities, traded on the organized market, and in redeemable units in UIFs will avoid the income tax. Changes that are even more important will take effect from next year – there will be an opportunity to open individual investment accounts (IIA). These are like IRA accounts (ISA in Great Britain, etc.). But in comparison to IRA one should not wait until retirement, since it is enough to hold this account for 3 years in order to get tax privileges. An amount that can be entered into the IIA is even greater than by IRA and many other similar accounts – more than 10 thousand US dollars a year per family member. Just as by the IRA, you are able to return from the budget that income tax you paid for the entered amount annually or avoid

taxation in case of withdraw resources from the account in three or more years. Also just as by IRA, all income that you receive from transactions on the IIA, will not be taxed until you close it. The new rules significantly improve the profitability of operations in securities and make such operations a viable alternative to bank deposits. I believe that we have formulated a convincing invitation to the securities market for individuals and hope to see the number of retail investors grow. Then, the problem of financial literacy will escalate.

7. Increasing the efficiency of the market will demand changes that go beyond simple regulatory measures. Your comments.

This is true. When I think about it, I guess that more effective are solutions, addressed to the motives of regulated relations members rather than straight rules. In this respect, changes of the legal paradigm are a challenge for all regulators.

8. Indo-Russian trade relations are set to make a new beginning. What value addition do you think the two can bring in financial markets for common benefit?

Development of trade relations is always helpful for the development of the financial market. Financing of trade and new companies is possible if the financial market of our countries – individually and collectively – is developed enough and is ready to provide it.