Developments in the Post-trade Infrastructure in Eurasia

Thomas Murray's Ana Giraldo reports on post-trade infrastructure developments in the Eurasia region and highlights issues to watch in evaluating Capital Markets Infrastructure risk

The countries in the Eurasian region had to develop new market infrastructure from scratch following the dissolution of the Soviet Union in 1991. After many years of closed economies and a fully state-controlled market, the local capital markets were kick-started by coupon privatisation programmes, requiring an infrastructure to support them. This meant re-opening of local stock exchanges, the introduction of central securities depositories (CSDs) plus registrars and development in payment systems. Since then, some of these countries have emerged from the shadows to become important world players, while others have struggled to compete in a globalised world.

The lag in capital markets development resulted in market fragmentation and competition between infrastructure entities. It is common to find (although less as the countries have developed) a number of entities acting as de facto depositories, such as custodian banks, which were given a series of securities under custody and therefore a "depository" responsibility for those issues. There are also several

CMIRR Ratings Definitions:

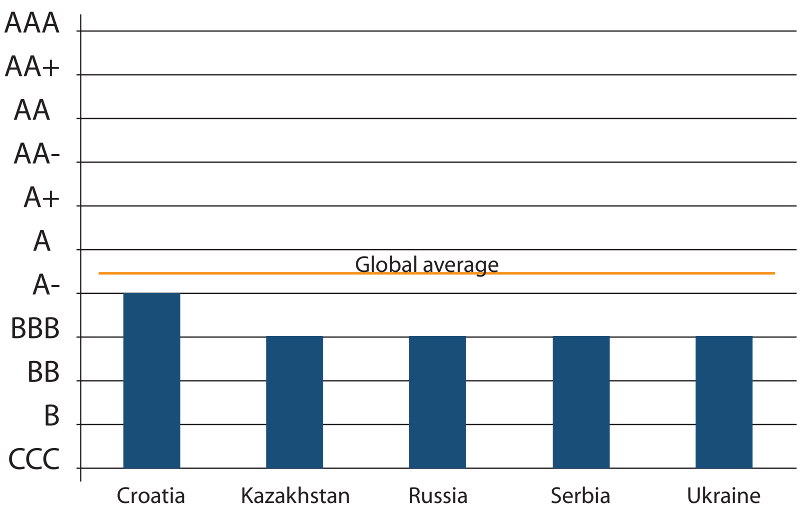
AAA	extremely low
AA+, AA, AA-	very low
A+, A, A-	low
BBB	acceptable
BB	less than acceptable
B	quite high
CCC	high
CC	very high
C	beyond any acceptable level of risk exposure

registrars in a number of markets that are responsible for maintaining ownership records as appointed by the issuer. This has created ambiguity as to where legal ownership is granted.

Given the lack of consolidated post-trade infrastructures in many markets in the region, and the significant amount of securities held in decentralised form (mainly with the registrars or custodians and outside of the depositories), the Capital Markets Infrastructure Risk Ratings assigned by Thomas Murray for the Eurasian countries have been relatively low compared to the global average, as shown in the chart below:

The chart above shows the overall capital markets infrastructure risk ratings (CMIRR) for the Eurasian markets Thomas Murray covers. The overall rating is a weighted average of the different risk components including asset commitment risk, liquidity

Capital Market Infrastructure Risk Rating in Eurasia



risk, counterparty risk, financial risk, operational risk and asset servicing risk. The CMIRR ratings are assigned to the market infrastructure as a whole, including all CSDs in the market, physical securities, payment systems, local regulations, etc.

Despite the low ratings, there have been a number of recent developments taking place that will contribute significantly to the development of the post-trade infrastructure in the region.

Market-level developments

Russia, which is the largest market, developed for many years an infrastructure that was highly fragmented, with two competing vertical silos: The Moscow Interbank Currency Exchange (MICEX); and the Russian Trading System (RTS). Each one developed its own post-trade infrastructure such as a securities settlement depository and a cash settlement house to process the clearing and settlement of transactions. In addition, there were a multitude of registrars located throughout Russia that also conducted ‘settlement’, and a number of custodian banks that acted as ‘depositories’. However, in 2011 the landscape changed when the two silos agreed to merge.

As a result, there is now a single stock exchange known as Moscow Exchange MICEX RTS, which is the main marketplace for equities, corporate and government bonds and derivatives traded on-exchange (although separate platforms still remain in place). The depositories, the National Settlement Depository (NSD) and the Depository Clearing Company (DCC), are currently undergoing a consolidation process to develop a single depository in the market under NSD’s operating model. Almost simultaneously with the merger process, the regulator issued a definitive version of the Central Securities Depository (CSD) law, which came into effect from 1 January 2012. The law envisages that only the CSD will be able to hold accounts at the registrars, and that all listed securities need to be settled within the depository. In addition, amendments to the securities market legislation included the introduction of the nominee concept for foreign investors, the lack of which had been generating a serious asset safety risk concern for foreign investors.

The effects of these changes are expected to be significant within Russia as well as other CIS countries. In Russia, it is expected that some global custodians, which were previously unable to open accounts at NSD or DCC owing to Russia’s lack of compliance with the U.S. SEC 17f-7 regulation, will move their holdings from the registrars to the CSD. SEC 17f-7 stipulates that US global custodians are only allowed to maintain accounts in depositories that meet certain requirements, including being a system offering central handling of securities and holding assets of all participants on equivalent terms. Since Russian law was ambiguous as to where legal title was granted, at the depository or registrar level, most custodians decided to maintain accounts with the registrars. These changes should also benefit Russia's plans to develop an International Financial Centre in Moscow, as well as improve the asset safety risks for foreign investors who can now maintain securities at the global custodian's nominee accounts without the risk of their assets being commingled in the event of bankruptcy. Dematerialised securities will also move from the registrars to the depositories.

President of Ukraine to the possible negative consequences of the entry into force of the law. It is yet to be seen how the dispute will resolve, but the consolidation of the infrastructure with a single CSD would be a step forward in the market's development.

Croatia went through its own infrastructure consolidation back in 2004 when securities were transferred from the Croatian National Bank and the Ministry of Finance – which both operated a CSD for some specific types of securities – to the Sredisnja Depozitarna Agencija d.d. (SDA), the Central Securities Depository, now known as Središnje Klirinško Depozitarno Društvo, dionicko društvo (SKDD d.d. – the Central Depository & Clearing Company Inc.).

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But the changes are likely to have a wider effect in the region as other countries follow in Russia's footsteps. In Ukraine for instance, the Parliament adopted the Law "On the Depository System of Ukraine" under which a single CSD and a single Clearing Centre (CCP) are to be established. Although the infrastructure consolidation is positive, the law envisages that the National Depository of Ukraine (NDU) will be appointed as the single CSD, while the All Ukrainian Securities Depository (AUSD) will be appointed as the CCP. However, NDU's experience as a settlement depository is limited and it does not have the full support of the market. Some market participants have expressed their disagreement strongly, including the Ukrainian Exchange which suspended trading on 20 September 2012 for one hour in order to attract the attention of the

Other markets, in particular in the CIS region, are still trying to develop themselves. Although most have a basic capital market infrastructure in place, much remains to be done. Given that they have only recently been inaugurated as independent countries and market economies, they continue to lag behind in terms of their levels of market development. However, as their economies grow and they open their markets to foreign investment, significant changes are likely to take place, including a potential reduction in the number of registrars, dematerialisation of securities, further expansion in the range of securities and instruments traded on and off exchange, and a centralisation of settlement procedures. In combination, these changes are likely to bring a general increase in the level of sophistication of these CIS capital markets. ■