



RUSSIAN FEDERATION

FINANCIAL SECTOR ASSESMENT PROGRAM

DETAILED ASSESSMENT OF IMPLEMENTATION

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

September 2016

This Detailed Assessment of Implementation on the Iosco Objectives and Principles of Securities Regulation on the Russian Federation was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on September 2016.

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Prepared By
**Monetary and Capital
Markets Department**

This Detailed Assessment Report was prepared by Richard Britton and Richard Pratt (external experts) in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in the Russian Federation during February, 2016. The FSAP was led by Karl Habermeier, IMF, and Aurora Ferrari, World Bank, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance and Markets Global Practice, World Bank. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>, and www.worldbank.org/fsap.

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Glossary

AML	Anti-Money Laundering
AUM	Assets Under Management
CBR	Central Bank of the Russian Federation
CEO	Chief Executive Officer
CIS	Collective Investment Scheme
CPD	Continuing Professional Development
CRA	Credit Rating Agency
FFFSS	Federal Fiscal and Financial Supervision Service
FSC Com	Financial Stability Committee
FSFM	Federal Service for Financial Markets
FSFR	Federal Service for the Regulation of Securities
FSB	Financial Stability Board
FSD	Financial Stability Department
FSR	Financial Stability Review
FX	Foreign Exchange
HFT	High Frequency Trading
ISA	International Standards of Accounting
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
IT	Information Technology
MC	Management Company
MED	Ministry of Economic Development
MICEX	Moscow Interbank Currency Exchange
MMoU	Multilateral Memorandum of Understanding
MOEX	Moscow Exchange
MoF	Ministry of Finance
MoI	Ministry of the Interior
MoJ	Ministry of Justice
NAUFOR	The National Association of Securities Markets Participants
NAV	Net Asset Value
NAFARS	National Organization for Financial Accounting and Reporting Standards
NCC	National Clearing Center
NCFS	National Council on Financial Stability
NFEs	Nonbank Financial Entities
NST	Non-Standard Transactions
OT	Organized Trading Law
OTC	Overt-the-Counter
RAS	Russian Accounting Standards
RM	Risk Management

SD	Specialized Depository
SIFIs	Systemically Important Financial Institutions
SRO	Self-Regulating Organization
UIF	Unit Investment Fund

EXECUTIVE SUMMARY

- 1. The Central Bank of the Russian Federation (CBR) has recently completed a two-year process of assuming the powers and functions of the previous “standalone” regulator of the securities markets and the insurance industry.** This has included absorbing 1,300 new staff and inducting them into the organizational structures of the central bank. In addition to its new supervisory functions covering a disparate group of markets and professional market participants, it has also assumed a developmental role for nonbank financial markets with an emphasis on developing proportionate regulation and optimizing the regulatory burden on market participants. This is a challenging medium to long-term role while also seeking to ensure that standards are raised and that undesirable elements are removed from the market as rapidly as possible.
- 2. As is reflected in the ratings for many of the principles, there is much that CBR needs to accomplish if it is to approach good international practice as a securities regulator.** The assessors have observed many positive elements in the work that supervisors are undertaking on a daily basis and in the longer-term work of developing policy that can be translated into the supervisory agenda. The fact remains that there is a significant amount of work to achieve full compliance. The departure from the International Organization of Securities (IOSCO) requirements sometimes results from the absence of specific requirements in the legal framework, or insufficient implementation in practice. An additional cause is the complex legislative structure that is highly detailed, consists of many overlapping and in some cases inconsistent provisions that impose many detailed obligations but fail to impose the overarching duties required by IOSCO. The result is not easy to understand or enforce, leaves gaps, and yet creates substantial compliance costs. While some have argued that the absence of overarching provisions is an inevitable consequence of the principles of Russian law, others have correctly pointed out that there are some overarching obligations already in the legal framework and steps are being taken to develop the approach to legislation on these lines.
- 3. Some of the most recent regulatory changes, such as those on credit rating agencies, are clearly based on international standards.** In other areas, further initiatives will be required. These include conflicts of interest identification and improving standards of management in professional market participants. It will also require the creation of legal gateways which will enable supervisors with the necessary skills sets to provide guidance as to what CBR’s reasonable expectations are on a range of issues. These include the necessary components of RM (RM) and internal control systems and the fair treatment of clients. Client facing rules require improved checks and balances within licensees which seek to ensure that clients, particularly unsophisticated retail clients, are advised on and sold products which meet their personal (often multi-dimensional) needs in a way which the current limited criteria for customer profiling fail to do. Further initiatives are also necessary in areas such as the prospectus and continuous disclosure regimes for listed companies and the need for easy to understand disclosure documentation for unit investment funds that still provide sufficient, and sufficiently accurate information to enable the man or woman in the street to understand the risks and rewards and to make an informed investment decision. The retail investor base is small, and such initiatives could make a significant contribution to the numbers participating.

4. CBR faces a major challenge in enforcing the regulatory regime and will need additional resources. Over the financial sector as a whole, there are 19,000 nonbank licensees within the responsibility of CBR. With some 250 members of its inspection team, it was able to carry out scheduled, or routine inspections of just 97 of these in 2014. Most inspection resources were devoted to 499 unscheduled inspections (investigations into complaints or allegations of regulatory breaches). There is scope for greater use of supervisory tools other than inspections. Moreover, the move to place more responsibility on self regulatory organizations (SROs) may reduce the burden on CBR staff in the long term while increasing it in the short term as the new regime is developed. There will be a need for more resources to enable CBR to conduct a fully effective enforcement regime.

5. In other areas where change is underway, the ultimate goal may be clear, but the route will be difficult to follow. One example is accounting standards, where the move to International Financial Reporting Standards (IFRS) is taking place while a requirement to publish accounts according to Russian Accounting Standards (RAS) remains. On insider trading and market manipulation, investors globally will expect to see results from the new law, at least in terms of criminal prosecutions presented in court, in the near term.

INTRODUCTION

6. An assessment of the level of implementation of the IOSCO Principles in the Russian Federation was conducted from February 3–16, 2016 as part of the Financial Sector Assessment Program (FSAP) by Richard Pratt and Richard Britton, both external Monetary and Capital Markets Department experts. The last IOSCO assessment was conducted in 2011 when the statutory regulator was the Federal Service for Financial Markets (FSFM). Its powers and functions were subsumed into CBR in September 2013 and the integration process was completed in the course of 2015.

7. CBR has created a three-year strategy on financial market development and stability; one of its goals for the period of 2016–18 is creating conditions for the growth of the financial industry. It has identified as critical to the achievement of that goal “enhancing financial market regulation, inter alia through proportional regulation and optimization of the regulatory burden on financial market participants.” Consistent with that goal is the adoption of international standards as established by IOSCO and appropriately adapted to the Russian market and legal system.

8. The assessment was conducted based on the IOSCO Principles and Objectives of Securities Regulation approved in 2010 and its Methodology adopted in 2011 and updated in 2013. Principle 38 was not assessed since this principle is now covered under the principles for Financial Market Infrastructures (PFMI). As a result, issues related to the central counterparties are not covered in this assessment.

9. The assessors relied on a number of information sources: a review of relevant laws, regulations, directions, instruction codes, and other documents provided by CBR; bilateral discussion with senior CBR staff in the weeks preceding the mission and a self-assessment prepared by CBR. In

Moscow the assessors met with Mr. Sergei Shvetsov, First Deputy Governor of the CBR, senior CBR staff, senior officials at the Ministry of Finance (MoF) and the Ministry of the Interior (MoI), and with the Moscow Stock Exchange and other representatives of the private sector.

10. The assessors want to thank CBR staff for their full cooperation as well as their willingness to engage in open conversations regarding their supervisory and regulatory work.

The assessors also want to extend their appreciation to the other public authorities and market participants with whom they met.

REGULATORY STRUCTURE

11. CBR is the supervisor and regulator of the financial services sector; it is also the central bank. It is established under the Federal Law No. 86-FZ of July 10, 2002, "On the CBR" (Central Bank Law). It is a legal entity. Its authorized capital and other property is in state ownership. Its assumption of powers and functions over the nonbank financial sectors was achieved by Federal Law No. 251-FZ of July 23, 2013 "On Amendments to Certain Russian Federation Legislative Acts in Connection with the Transfer to the Russian Federation Central Bank of Powers of Regulation, Oversight and Supervision in the Area of Financial Markets," which transferred to CBR the powers and functions previously exercised by the Federal Service for Financial Markets (FSFM). The Central Bank Law sets out the governance and management structure of CBR and its powers, duties and functions, including its powers to determine staff hiring and remuneration policies, its duties and functions to act as the central bank, conduct monetary policy, oversee payment systems and to conduct integrated supervision of the financial services sector. It is also responsible for supervising the conduct of takeovers and mergers of companies that have issued securities to the public.

12. Other government-appointed bodies have relevant regulatory roles. The Ministry of Economic Development (MED) is the body responsible for administering the Joint Stock Companies Act, although disclosure requirements for companies offering securities to the public are the responsibility of CBR. The MoF is responsible for setting accounting and auditing standards and it relies upon advice from the National Organization for Reporting Standards and the Audit Council respectively, both of which are independent of the profession. Auditors are relied upon to enforce accounting standards and enforcement of audit standards is undertaken by the Federal Financial and Fiscal Service (for public interest companies) and Self-Regulatory Organizations (for all audit firms). The SROs of auditors are supervised by the MoF. The Federal Anti-Monopoly Service can intervene in markets supervised by CBR.

MARKET STRUCTURE

A. Market Intermediaries

13. The intermediaries licensed by CBR are brokers, dealers, investment managers, custodians, and registrars. Investment advisers are not separately licensed. Underwriting is considered to be an activity encompassed within the definitions of brokering and dealing.

14. Most intermediaries hold multiple licenses. According to the National Association of Professional Securities Participants (NAUFOR), 59.7 percent of the licensees held licenses as brokers, dealers and investment managers. Of these, 65 percent also had licenses as depositories. Data from CBR confirm this. On January 21, 2016, there were 826 brokers, dealers, asset managers and custodians, most of which had multiple licenses.

Table 1. Securities Licensees

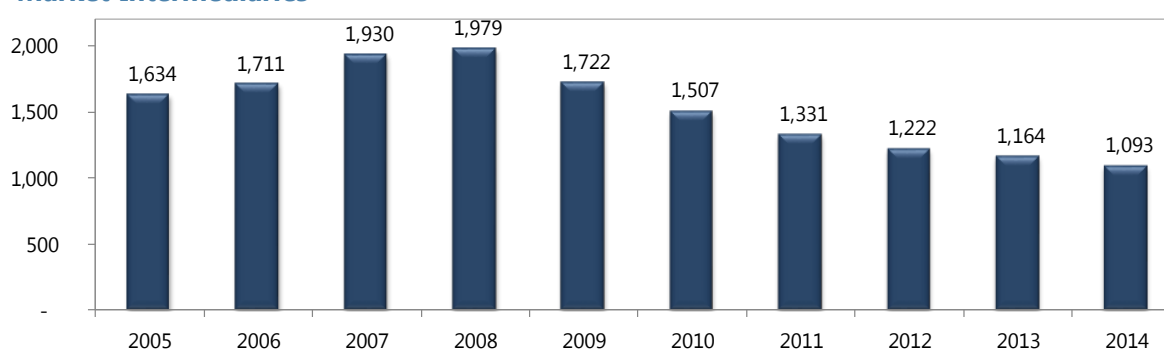
Licenses Issued	Number
Broker	624
Dealer	641
Investment Manager	533
Depository	498

Source: CBR.

15. The number of intermediaries has been declining as is shown in the figure below.

Figure 1. Market Intermediaries

Market Intermediaries

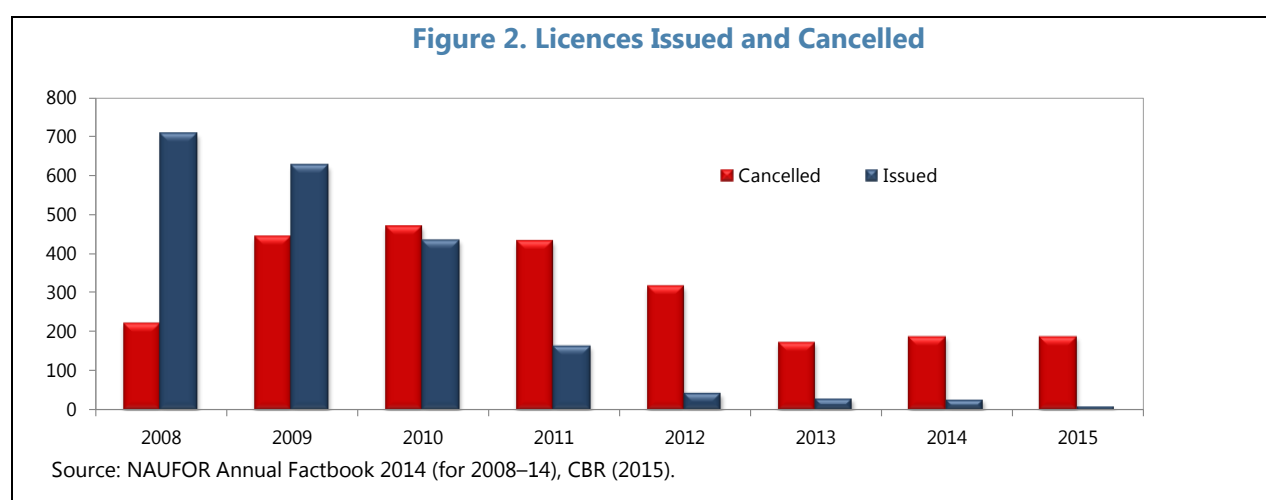


Source: NAUFOR Annual Factbook 2014.

16. This trend has continued, as CBR has been reviewing the status of intermediaries that undertake very little business. By the beginning of 2016, according to CBR, the total number of

intermediaries had fallen to 826, a reduction of 18.7 percent over the year.¹ CBR has noted that the steady and substantial reduction in the number of intermediaries has not had any appreciable effect on trading volume.

17. The trend of license granting and cancellation has varied considerably since 2008. The number of new licenses has reduced over time and the number of licences cancelled has exceeded those granted since 2010.



18. According to NAUFOR, 536 organizations traded on the exchanges in 2014, of which the top ten firms accounted for 63.9 percent of the volume of trading, up from 61.9 percent the previous year. The most active trader in non-government securities was CBR which accounted for 21.4 percent of the total turnover, down from 22.7 percent in 2013. CBR was particularly dominant in the market for corporate bonds (where its share was 32.9 percent, as opposed to 3.4 percent of the market for shares). The Sberbank Group (in which CBR has a shareholding of 50 percent plus one share) accounted for 15.5 percent of the market in shares (where it was the most significant trader) and 10.0 percent of the market in corporate bonds, where it was second largest to CBR.²

19. Top ten traders in non-government securities by volume are shown in the Table below.

¹ January 21, 2016.

² Source: Sberbank.

Table 2. Top Government Securities Traders

	Name of Organization	Share of Volume (In percent)
1	CBR	21.4
2	Otkrytiye Group	9.7
3	Sberbank Rossii Group	8.9
4	VTB Group	8.5
5	BCS Group	3.9
6	Gazprom Group	3.2
7	Renaissance Group	2.5
8	Vnesheconombank Group	2.1
9	Bank Saint Petersburg JSC	1.9
10	BC REGION LLC	1.9
	TOTAL	63.9

Source: CBR.

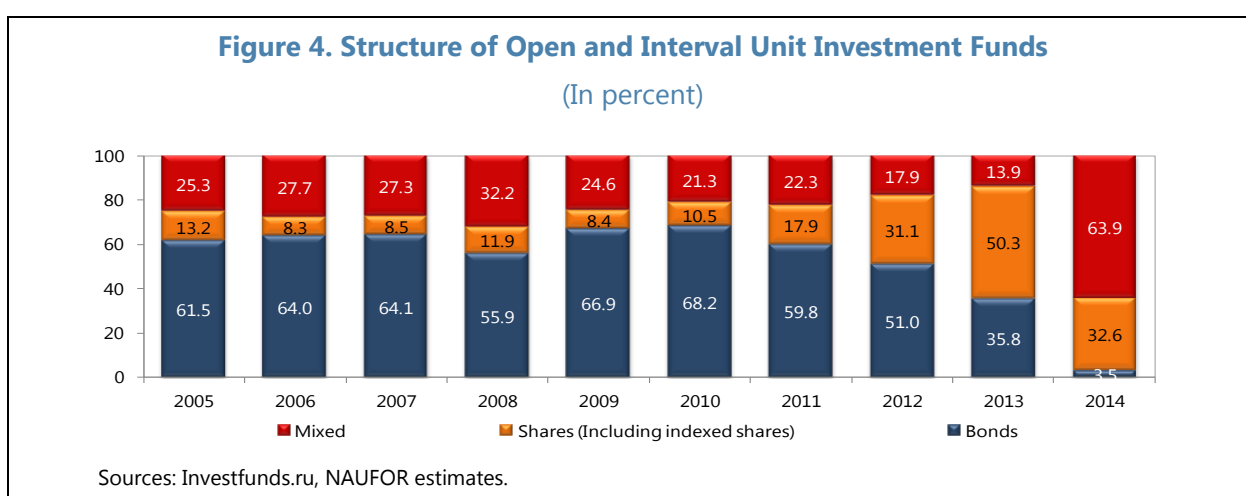
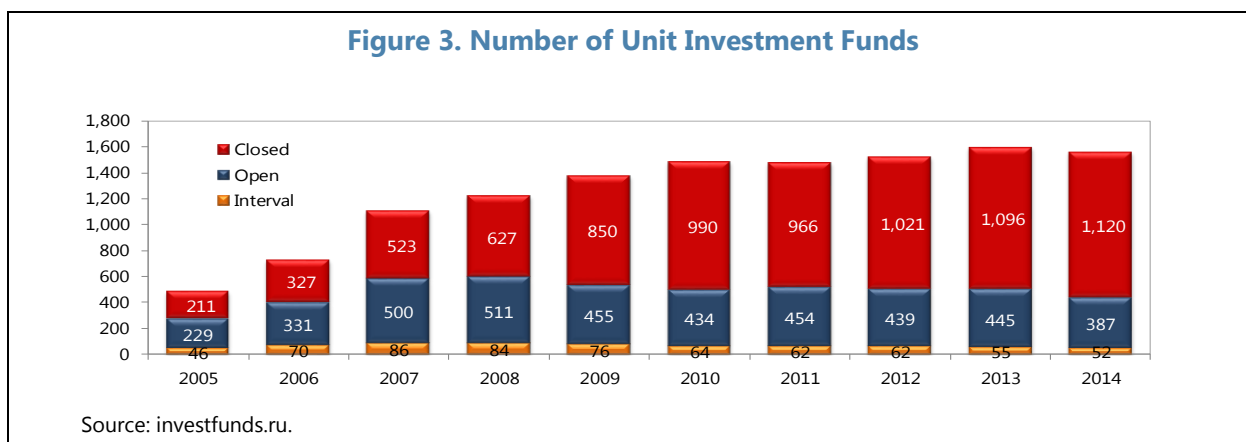
B. Collective Investment Schemes

20. At the end of 2014, there were 1,584 unit investment funds (1542 as of 3Q2015), a decline of 2.3 percent from 2013. The number of open-end mutual funds, which are focused on retail investors, decreased by 5.5 percent, while the number of closed-end mutual funds decreased by 2.2 percent. Closed-end funds remained the most common type of fund, amounting to 72 percent of the total number of unit investment funds. The assets under management (AUM) decreased by 3.1 percent to RUB 569 billion (470 as of 3Q 2015). The AUM of open and interval funds decreased by 24 percent to RUB 92.6 billion.³ This was the first time the value of open and interval funds had dropped below RUB 100 billion since 2010. AUM represented 0.13 percent of GDP.

21. The most significant structural change for 2014 was related to mixed investment funds.⁴ These funds became the largest group, comprising 63.9 percent of the total net asset value (NAV) of open and interval funds.

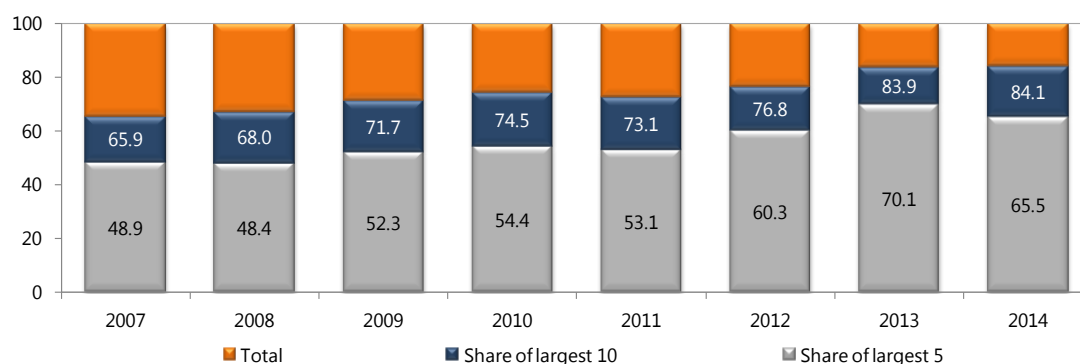
³The holder of units of an interval fund has a right to redeem all, or any part, of their units, but only on the dates established by the fund's trust management rules.

⁴ Mixed funds invest in other funds or in a mix of shares, bonds, and cash.



22. Since 2007, the share of the ten largest management companies of total AUM has been on an upward trend. At the end of 2014, the AUM of the ten largest management companies made up 84.1 percent of the total market of open and interval funds. Notably, the second largest management Company (MC) is part of the largest Austrian banking group (by balance sheet size).

Figure 5. Share of the Ten Largest Management Companies
(In percent)



Source: investfunds.ru, NAUFOR estimates.

Table 3. Largest Asset Management Companies (end 2014)

No.	Managing Company	AUM (In millions of rubles)	Share in the Total NAV (In percent)	Number of Funds
1	Sberbank Asset Management CJSC	20,074.0	21.9	19
2	Raiffeisen Capital LLC	16,304.1	17.8	18
3	URALSIB LLC	8,933.9	9.8	19
4	Alfa-Capital LLC	7,706.6	8.4	17
5	Trust Investment Company, LLC	6,918.7	7.6	3

Source: BCR.

C. Markets

23. The Moscow Exchange Group (MEG) is the largest exchange group in Russia, operating trading markets in equities, bonds, derivatives, the foreign exchange market, money markets, and precious metals. MEG also operates Russia's central securities depository (National Settlement Depository) and the country's largest clearing service provider (National Clearing Centre). The exchange was established in December 2011 by merging the Moscow Interbank Currency Exchange (MICEX) and the Russian Trading System (RTS). MEG's shares are publicly traded on the exchange. As of November 2014, the largest shareholders of the Exchange were CBR (11.75 percent), Sberbank (9.9 percent), Vnesheconombank (8.4 percent), European Bank for Reconstruction and Development (6.1 percent), and Shengdong Investment Corporation (5.6 percent). Commodities trading is provided by five exchanges (St. Petersburg International Mercantile Exchange; "Exchange Saint-Petersburg" CJSC; Moscow Energy Exchange; Saint-Petersburg Exchange; NAMEX).

24. In 2014, the behavior of the markets was determined not primarily by fundamental factors such as poor economic indices but by the evolving geopolitical situation such as sanctions imposed against Russia by the United States (U.S.) and European Union (EU), the fall in oil prices, and capital outflows. The stock market showed negative results in almost all respects. The turnover ratio of the domestic share market was 36.0 percent in 2014, which was slightly greater than that in the previous year. However, comparing with the maximum level observed in 2009, the domestic share market liquidity decreased by 2.6 times.

Investor profiles

25. Although the number of private investors rose from 838,000 people to 906,000 people, the number of active private investors' customers decreased slightly to 62,500 from 62,900 people in the previous year. Private (resident) investors, who make up 90.3 percent of the total number of transactions on the Moscow Exchange, invest predominantly (89 percent) in shares. The number of corporate investors increased in 2014 by 8.8 percent to 19,800. However, the number of active corporate investors decreased to 1,422 companies or some 4.0 percent of the total number of investors.

Table 4. Capitalization of Russian Market (Equities) on MEG in 2010–14

Period	In billions of rubles	In billions of U.S. dollars (Estimate)	Capitalization as percent of GDP
2010	29,253.2	1,379.2	63.2
2011	25,708.0	1,096.2	46.1
2012	25,212.5	1,079.4	40.4
2013	25,323.8	1,041.1	38.0
2014	23,155.6	517.3	32.6

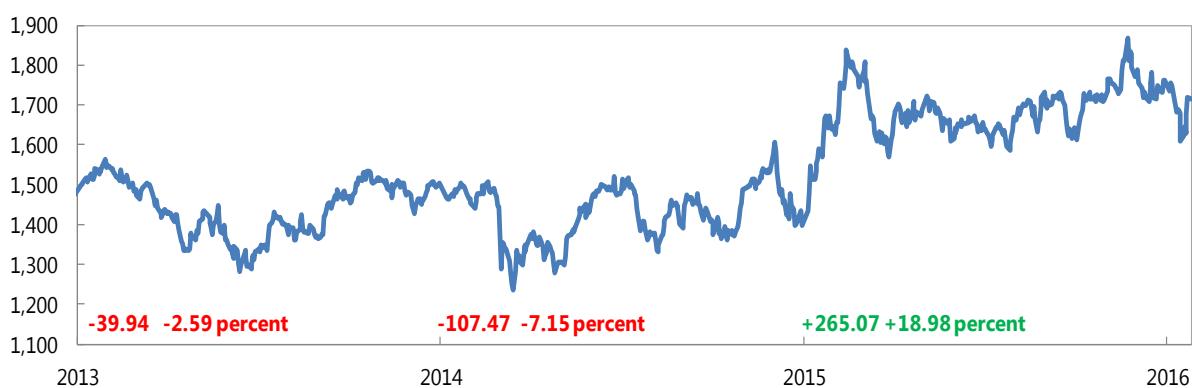
Source: MICEX.

Table 5. Number of Listed Companies on the Moscow Exchange 1/

Period	Moscow Exchange Group	
	Number of Share Issuers	Number of Share Issues (ordinary, preferred) in Quotation Lists
2011	320	119
2012	275	118
2013	273	110
2014	254	106

Source: MICEX.

1/ Despite the trend of reduction in the total number of open joint-stock companies, there are currently 30,360 such legal entities. Less than one percent of them are represented on the stock exchange.

Figure 6. MICEX Composite Index 2013–14

Source: MICEX.

26. After a strong start to 2015 the market (as represented by the MICEX Composite Index) traded in a narrow range for the rest of the year.

27. Corporate Bond Market. In 2014, new issues of corporate bonds totaled RUB 1.8 trillion, which was 6.6 percent more than in the previous year. The share of off-market over-the-counter (OTC) placements grew sharply to 68 percent. The number of bond issuers on the Moscow Exchange remained unchanged at 323 companies. The total value of exchange transactions (at cost, without taking into account repurchase agreement (repo) transactions and placements) involving corporate bonds was RUB 4.3 trillion, which was 30 percent lower than in 2013. Secondary market trading in on-exchange bonds made up 30 percent of the secondary market volume. 45 percent of the turnover was in the bonds of 10 issuers.

28. Government Bond Market. The value of government bond issues traded on the exchanges continued growing in 2014 and, at year-end, had increased by 26 percent (par value), reaching RUB 4.7 trillion or 6.6 percent of GDP. However, exchange turnover was sharply lower—the secondary market volume (at cost, without taking into account repo transactions and placements) decreased by 36 percent to RUB 3.8 trillion for the year.

29. Sub-federal and Municipal Bond Market. This market segment has been and remains the most illiquid sector of the domestic debt securities market. The value of these bond issues made up less than RUB 500 billion, with the value of trading (without taking into account placements of new issues and repo transactions) being RUB 379 billion.

30. Repo Market. The Moscow Exchange is unusual globally in that it hosts a very large repo business. The value of exchange repo transactions on the Moscow Exchange in 2014 was RUB 183 trillion, which was 10 percent lower than in 2013. The share of corporate bonds in the total transaction volume shrank to 39 percent. The share of direct repos with CBR reached 55 percent at the end of the year.

Unit investment funds

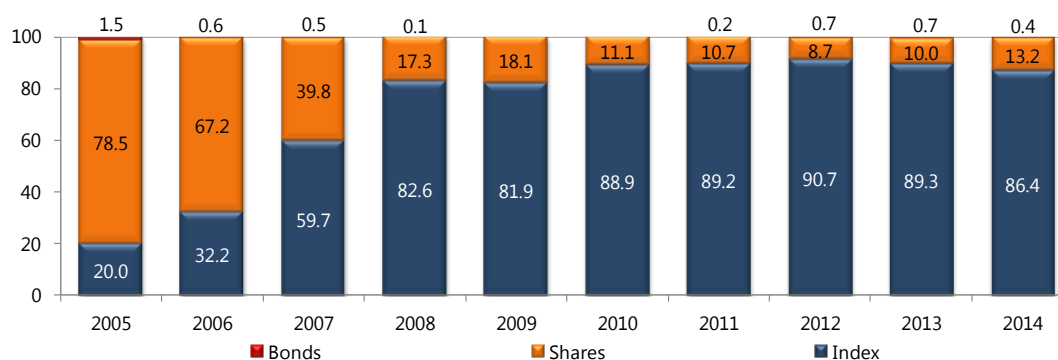
31. In 2014, the value of trading in investment units on the Moscow Exchange was RUB 177.3 billion, +28.6 percent over 2013. A significant innovation was the introduction in 2013 of stock exchange trading in foreign exchange traded funds (ETF). The aggregate volume of transactions in ETF units has grown by seven times for the year and made up RUB 3.5 billion. However, it accounted for about two percent in the total value of transactions in investment units.

Derivatives markets

32. Futures and options trading is dominated by trading in contracts on the Moscow Exchange (MOEX) indices. In 2014, the value of trading in futures contracts for securities and stock indices declined for the third year in a row at RUB 28,929 billion (-8.2 percent versus 2013). From 2011, when the maximum trade volumes were recorded, the decrease was 37.3 percent. The proportion between trade in futures and options was unchanged: 87 percent in futures and 13 percent in options.

Figure 7. Structure of Futures Trade on the Derivatives Market of the Moscow Exchange Group

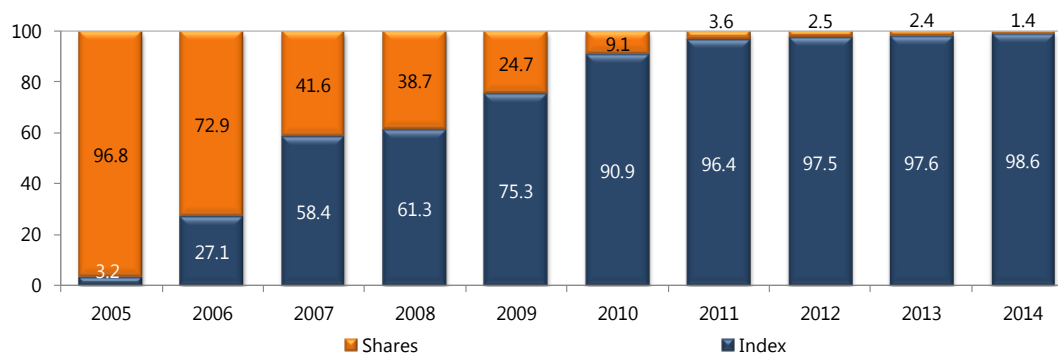
(In percent)



Sources: Moscow Exchange Group, NAUFOR estimates.

Figure 8. Structure of Options Trade on the Derivatives Market of the Moscow Exchange Group

(In percent)



Sources: Moscow Exchange Group, NAUFOR estimates.

D. Preconditions

The legal framework

33. One important precondition for securities markets is a stable and transparent legislative and regulatory framework, but the Russian Federation regulatory framework cannot be so described.

34. The Russian Federation legislative system follows many of the principles of civil law. Like most countries (civil or common law), there is a legislative hierarchy, with the Constitution at the top. As with other Civil Law countries, the Russian Federation incorporates a fundamental Civil Code. CBR is able to issue by-laws on matters within its competence and can do so on its own authority, where there is explicit provision in primary legislation. These by-laws, which all have to be registered with the Ministry of Justice (MoJ), take the form of Regulations, Directions and Instructions. The main difference is their internal structure. Regulations set basic or systemic rules, Directions set other rules, and Instructions tend to deal with the procedural application of the rules. These instruments are binding on all federal governing bodies, governing bodies of the constituent entities of the Russian Federation and local authorities, and all legal and natural persons. In practice, most of them are directed at securities businesses.

35. The assessors have noted a number of issues arising from the structure of the legislation. In particular, it is clear that:

- **The legislation is subject to constant change.** Even primary laws are often amended several times a year. For example, the Securities Law was amended five times in 2015, each amendment resulting in multiple changes to a substantial number of articles. Although the legislative system is highly efficient at showing the legislative history in each act, it remains difficult to keep track of the implications and consequences of all the changes.
- **Not all of the provisions in new or amended legislation result in comprehensive amendments or repeal of previous provisions.** Some examples are given in the text of this assessment and include the law on SROs, which was brought into effect in January 2016, without repealing the existing articles relating to SROs in the Securities Law and the Investment Funds Laws. The provisions regarding the process and criteria for registration of SROs, their rights and duties were different in each of the Securities Law, the Investment Funds Laws and in the new provisions in the new SRO Law and yet all remained in force at the same time. This resulted in membership in SROs being both voluntary and mandatory (at the same time) for professional securities firms. The transition to the new regime has been constructed in a way that results in securities firms being obliged to comply with basic standards that are not yet drafted. CBR have explained the principles for resolving inconsistencies and these are discussed below. However, reliance on such general principles will still leave uncertainty and the existence of such principles is no substitute for a proper analysis of the potential conflicts or inconsistencies between new and previous legislation and the introduction, simultaneously with new legislation of all necessary repeals and amendments to previous legislation.
- **Provisions relating to any one matter can be found in a large number of different legislative instruments.** Again examples are given in the text of the assessment and include the range of obligations placed on the staff of CBR that extend across several pieces of legislation. Another example concerns the obligations on issuers of securities, which appear in various laws and the Civil Code, all of which have to be read together to get the full picture even though the existing provisions in different laws do not always make reference to the relevant qualifying provisions in other laws. Disclosure requirements relating to substantial shareholdings are set out in the Joint

Stock Company but can only be properly understood by referring to the definition of an affiliated person which appears in other legislation. While the notes to the Joint Stock Company Law give references for this definition, CBR has stated that the true definition can only be found by referring to two competition laws.

- **The approach to the nature of legislative provisions also changes in different laws.** For example, in many laws, including the Securities Law, the duty of CBR to keep information confidential is explicitly overridden where disclosure is required or permitted by law. In the Investment Funds Law, by contrast, the threat of personal civil liability that hangs over all CBR staff in the event that they make a disclosure (Article 56) is not explicitly overridden by any other legal requirement, although CBR has explained that this should be inferred. The right of CBR to refuse to give a license if criteria are not met is explicit in some laws but must be inferred in others. For example, the Investment Funds Law explicitly states that CBR has the right to give or refuse licenses based on the criteria. However, the Securities Law does not include such a provision for CBR in respect of brokers, dealers or investment managers, even though it is stated that CBR is the licensing authority and that there are licensing criteria. The power of CBR to give or withhold licenses based on the criteria has to be inferred.
- **The introduction of a new requirement is not always accompanied by the repeal of the existing requirement.** The legally binding requirements in CBR Regulations, Instructions, and Directions, sometimes overlap with existing provisions in Regulations and Orders published by the former securities regulator.
- **Some legislative instruments contain requirements at an inappropriate level of detail.** For example, firms are given legally binding instructions on the persons to whom copies of a quarterly report should be given, how many copies to make, and how to indicate that they have been read.

36. CBR has explained that there are legal principles for resolving inconsistencies between laws. Like most countries, inconsistencies are resolved on the basis that the later law overrides the former one. Like most civil law countries, there is an additional principle that the more specific law overrides the more general one. Moreover, in the case of conflict, the courts will take the position that the interpretation that restricts liberty the least will prevail. It may well be that in many cases, this will result in clarity as to which provisions prevail. However, it may well also be that in other cases, this will not be so, and there will be some who are genuinely unclear as to the proper interpretation in any one case, without resorting to judicial decision.

37. CBR has also explained that the recent history of the Russian Federation has resulted in suspicion in the Duma and the public at large of state agencies and this militates against the granting of broad discretion to such agencies. This is the historical background behind the attempt to create a comprehensive set of specific requirements, rather than by setting overarching obligations. Inevitably, this approach leaves overlaps, loopholes and gaps (which are identified in the report), and which have to be addressed by new and amended regulations (which in turn exacerbates the problems caused by detailed requirements that are frequently changed).

38. The consequence of this approach is likely to be to increase costs. One intermediary informed the assessors that the legal department was larger than their trading department. In particular:

- Proper compliance is very costly because of the need to employ staff to keep up with the changes, to identify the overlaps, seek advice on the interpretation of the latter, assess the implications and consequences of the changes, and implement those changes in terms of amended internal procedures, staff training, revised manuals and so on.
- Costs also arise from the payment of fines for failure to comply with detailed rules.
- Detailed requirements in effect micromanage the operations of firms, and are viewed by firms as inhibiting innovation and development.
- CBR is obliged to spend considerable time explaining the intention behind its regulations.
- The focus on detailed rules means that overarching principle based requirements, even where they exist, can be ignored by securities firms as there is a reluctance to take enforcement action for a breach of a principle in the absence of a specific rule.
- The detailed rules will sometimes miss key requirements altogether—for example:
 - The internal controls regulation focuses exclusively on the appointment and duties of a compliance officer but does not contain requirements that would be essential to an effective system, such as an obligation to conduct a risk assessment, to prepare policies and procedures that followed from that risk assessment, to develop a management information system that allowed the management to monitor the effectiveness of its policies and procedures in mitigating risk, to train staff in the risk appetite of the firm and the policies and procedures, and to re-evaluate the policies and procedures at least annually;
 - Provisions on conflicts of interest for securities firms are incomplete and do not include a general requirement to identify conflicts of interest, avoid them, manage them, or decline to act; and
 - There are detailed requirements to obtain specific items of information on customer's objectives and circumstances but not an overarching requirement to obtain all information necessary to be able to judge the suitability of services.
- In practice, firms act in a way that is consistent with the detail of the rule but not the underlying intention, for example:
 - There are practices by the audit profession that are consistent with the detailed rules, but not the principle, regarding independence;

- Disclosures by companies are consistent with detailed requirements but not the general principle that all material matters should be disclosed where they may affect the price of securities (as is evidenced by the absence of profit warnings which although relevant to a securities value is not specifically included in the list of mandated disclosures).

39. The complex regime is difficult to comprehend and enforce. The assessors could not help noticing that regulations were suddenly identified at a very late stage in the mission (or in some cases after the mission). These regulations, such as Regulation 44 of 1998, were clearly relevant to a number of principles, but were not discussed by CBR in the self-assessment, or in the discussions (until the final meeting). This suggests to the assessors that CBR do not themselves have a clear and comprehensive picture of the regulations that apply and, it is highly likely that the intermediaries do not. This will mean that it is unlikely that all such regulations can be effectively enforced.

40. A regulatory regime that includes contradictions and inconsistencies can undermine respect for the rule of law. CBR have confirmed that they will not take enforcement action under the SRO Law against securities firms for failing to comply with non-existent SRO basic standards. However, it is not appropriate to have legal and regulatory provisions that cannot be complied with and must be ignored—even if, or, in fact, especially if, the enforcement authority has stated that they will take no action. If it were to become accepted that there may be some mandatory legal requirements that are impossible to comply with (and can safely be ignored with the agreement of CBR as enforcement authority), then the principle of the rule of law is undermined.

41. The reluctance to draft general, overarching requirements is gradually diminishing. The assessors have noted that there are some more general obligations (such as the requirement to have adequate RM and to have systems to identify and monitor conflicts of interest). Indeed, CBR found an old regulation issued in 1998, which contains very general and broad brush requirements on conflicts of interest. However, in these cases, there is no supporting detail and so it is not easy to judge the expectations of CBR. Moreover, even though these general requirements exist in some cases, some CBR staff continued to insist, from time to time in discussion and in comments in this report that such general requirements would be regarded as simply declaratory in the Russian legal system and would not be legally binding.

42. A reasonable balance between high level obligations, supported by a list of detailed but not exclusive examples, can clearly be struck and has sometimes been struck in the securities legislation.

43. The assessors understand that CBR is considering embarking on a simplification exercise and would encourage them to do so as soon as possible. In particular, it would be most helpful if:

- All new legislative instruments identified existing conflicting provisions (especially where these exist in laws administered by CBR) and repealed or amended them, so as to remove the potential for inconsistency;

- Provisions which deal with a particular subject should, so far as possible, be brought together, or at least cross referenced, so that those seeking to comply with their obligations can be confident that they can find them in a single place, where they relate to the same matter;
- The degree of detail that is required should be reviewed, so as to limit the extent to which the actions of securities firms are micromanaged;
- Greater use should be made of the kind of high-level obligations that are beginning to appear in legislation, so that those subject to the law can see the overall objective of the regulations and do not have the scope for slipping through the gaps created by different detailed provisions;
- Such overarching requirements should be supported by sufficient detail that focuses on the key elements that CBR regard as essential;
- CBR should seek to limit the number of amendments (an objective that should be easier to meet if there is less minute detail in individual instruments).

Business laws

44. Business laws in Russia are based on chapter 4 of the Civil Code, the 208-FZ Federal Law on Joint Stock Companies and the 14-FZ Law on Limited Liabilities Companies. The latest major amendments to business legislation were introduced with Federal Law 99-FZ and Federal Law 210-FZ, from 2014 and 2015 respectively, which changed the types of companies allowed in the Russian Federation, increased the protection of investors holding Russian local securities, and improved the conditions for participation in corporate actions (for example by allowing e-voting and e-proxy voting). The Insolvency Law was amended in 2014 to incorporate changes in the insolvency procedures for financial institutions. In 2015, amendments to the Federal Law No.7-FZ “On Clearing and Clearing Activities” empowered the National Clearing Center (NCC) to effectively segregate member positions from their client positions. The current legal structure meets the requirements for close-out netting of contracts under the International Swaps and Derivatives Association master agreements and the global master repo agreement of the International Capital Markets Association. Other important federal laws to register and conduct business are those related to state registration of legal entities and individual entrepreneurs, fundamental principles of Russian legislation on notaries, trade, consumer rights protection, and combating money laundering and the financing of terrorism, as well as the Land code, the CBR Law, and the Tax code. One of the most significant changes in these laws was the introduction of the requirement for financial institutions in 2013 to identify their clients, clients' representatives, and beneficial owners and to collect information on the reputation of them and on their business purposes. The definition of the “beneficial owner” was also clarified, and it currently is consistent with the Financial Action Task Force (FATF) Forty Recommendations Glossary.

45. The judicial power is formally independent from the legislative and the executive powers. The judiciary is primarily regulated by the Constitution of Russia, the Code of Criminal Procedure, the Code of Civil Procedure, the Code of Administrative Procedure, the Code of Arbitration Procedure, and the 1996 Federal Constitutional Law on the Judicial System of the Russian Federation.

According to the Constitution of the Russian Federation, the judiciary should protect all men (and women), and citizen's rights and freedoms. In addition, the Constitution confirms that courts alone can administer justice and requires that all judges shall be independent and obey only the Constitution and the law. The courts are financed solely from the federal budget in order to ensure a complete and independent administration of justice.

46. The judicial power is exercised by means of constitutional, civil, arbitration, administrative, and criminal proceedings. Examination of cases in all courts is open. Judges adopt the Code of Judicial Ethics which asserts the need to guarantee everyone's right to a fair consideration of a case by a competent, independent, and impartial court. The judicial system is composed of the Constitutional Court of the Russian Federation, the Supreme Court of the Russian Federation, federal courts, district courts, magistrate courts, military courts, and arbitration courts.

47. All judges of the Supreme Court are appointed by the Council of the Federation of the Federal Assembly of the Russian Federation upon recommendation of the President of the Russian Federation. All other judges, including military and arbitration, are appointed by the President of the Russian Federation.

48. The World Bank Global Competitiveness Report for 2014–15 ranks Russia as 109th out of 144 in judicial independence. In terms of the efficiency of the legal framework in settling disputes and in challenging regulations, Russia ranks 110th and 99th, respectively, and in the area of protection of property rights, Russia ranks 120th.

Legal profession

49. The legal profession is governed by the Constitution, the Law on the Status of Judges, the Law on Attorneys' Practice and the Bar, and the Foundations of the Legislation on Notary. The main legal professions in Russia are the public prosecutor, investigator, judge, attorney (advokat), and notary.

50. The public prosecution service consists mainly of the Prosecutor General's Office of the Russian Federation, the prosecutor's offices of the subjects of the Russian Federation, city, district and other territorial prosecutor's offices, and military and other specialized prosecutor's offices. The Prosecutor General of the Russian Federation must be appointed and removed from office by the Federation Council of the Federal Assembly of the Russian Federation by the recommendation of the President of the Russian Federation. The term of office of the Prosecutor General is five years. Prosecutors and investigators employed in the prosecution bodies should not be members of any elective or other bodies set up by state authorities and local self-government bodies.

51. The Investigative Committee of Russia is the main federal investigating authority in Russia. From 2011, this committee is not included in the structure of government authorities, and only the President of the Russian Federation carries out any control over the Committee. The Chairman is appointed and dismissed by the President without the approval of any body of legislative power and reports annually to the President on its activities.

52. All judges of the Supreme Court are appointed by the Council of the Federation of the Federal Assembly of the Russian Federation upon recommendation of the President of the Russian Federation. All other judges, including military and arbitration, are appointed by the President of the Russian Federation.

53. Lawyers must have a license to practice law in order to appear in court on criminal matters. Under the 2002 Law “On Attorneys’ Practice and the Bar,” each of the Russian regions has a single bar body called Bar Chamber. Lawyers need to be a member of one of such Bar Chamber to be recognized as an attorney.

Credit bureaus

54. Russia has 21 functioning credit bureaus according to the State Register of Credit Bureaus. These bureaus process and store credit histories and provide credit reports and related services. As of December 2014, the number of borrowers whose information is recorded in the credit bureaus is 61 million (60.7 million are individuals and 358,000 are legal entities). Some credit bureaus are owned by banks.

55. Credit bureaus are supervised by CBR and have been the subjects of reforms to strengthen the financial and real sector. The Federal Law “On Credit Histories” entitles the CBR to keep the central catalogue of credit histories which informs users, subjects of credit histories, and some other persons defined by law about the location of the credit histories. CBR has the power to request and receive credit history reports from credit bureaus.

MAIN FINDINGS

Principles relating to the regulator (Principles 1–8)

56. CBR is making significant advances in the regulation and supervision of financial markets since taking over responsibility for this sector. Full integration of the 1,300 staff of the FSFM was achieved only in 2015. In terms of governance, there are some concerns about the direct involvement of government at the Board level and in setting the bank’s budget. A more significant concern is the lack of legal protection for staff in the proper performance of their supervisory duties. The Central Bank Law and other legislative requirements seek to impose high standards of personal conduct and ethics on CBR staff, but greater clarity would be beneficial. On other matters, such as systemic risk in securities markets and perimeter policing, CBR meets IOSCO standards with only minor issues to be dealt with in the latter case. More needs to be done on developing an effective regime to deal with conflicts of interest and misaligned incentives.

Self-regulatory organizations, enforcement, and cooperation (Principles 9–15)

57. CBR has a comprehensive set of enforcement powers and is moving to a more risk-based approach to supervision and enforcement, but the resources devoted to supervision and particularly inspections are inadequate. CBR has enforcement powers that cover most of the

requirements of the principles. These powers are now being used with determination to identify and remove securities firms which conduct little or no securities market activity (and which probably should not have been licensed in the first place). For the remaining firms, CBR focuses on identifying breaches of the many detailed rules and applying penalties for such breaches. Most onsite visits to firms are “unscheduled”—i.e., are investigations arising from complaints or suspicions of breaches arising from other sources. The number of routine inspections is very low. In 2014, for the 19,000 nonbank licensees for whose supervision CBR is responsible in all financial sectors, there were 499 unscheduled inspections (i.e., investigations) and only 97 scheduled inspections.⁵ Only 250 inspectors are available to inspect all these licensees. This number of routine scheduled inspections is far too low for this to be described as an effective compliance program. Securities firms themselves report that CBR inspectors are beginning to engage in useful qualitative discussions of the effectiveness of RM as a whole. This is a positive development. CBR is moving towards a new regime where front line enforcement will be the responsibility of SROs and this will involve the transformation of the role of such organizations. This transformation needs careful management. Market abuse was criminalized only in 2013 and criminal penalties available only in 2015, and as yet only administrative penalties have been imposed.

58. CBR is a signatory to the multilateral memorandum of understanding (MMoU) and is actively responding to requests for information, even though some ambiguities in the law need to be removed. CBR became a signatory to the IOSCO MMoU in 2015. It has received and responded to requests for information. The Central Bank Law has been amended specifically to allow for CBR to use its powers to obtain confidential information in response to requests from foreign authorities. In most cases, but not all, the duties of confidentiality placed on the regulatory authorities contain an explicit gateway to allow disclosure when permitted by law and this practice needs to be comprehensive. The drafting of the Central Bank Law prohibits the provision of unsolicited assistance and this restriction on the otherwise wide powers of CBR need to be removed.

Issuers (Principles 16–18)

59. Disclosure provisions on issuers are reasonably comprehensive, but the continuing disclosure obligations need to be strengthened. Companies that have issued shares or bonds to the public are required to publish prospectuses and are also required to publish quarterly and annual reports. The requirements for prospectuses and for periodic reports are comprehensive. There is a general obligation to disclose all material facts relevant to a decision to invest in a prospectus and a corresponding continuing obligation to disclose all material facts that might affect the price of a security. In practice, however, disclosures are mostly limited to those included in a list of specifically required disclosures in the law, which includes routine matters such as the holding of a general meeting, or the terms and conditions of securities, but excludes many significant matters such as a material change in prospects or risks, or important events affecting performance and profits. These significant disclosures would be categorized as “any other matter” in the law and CBR has confirmed that they would expect significant disclosures to be made under that category, although very few disclosures (just over 1 percent of the total) are made on this basis. There is no formal derogation from

⁵ No figures are available for inspections of securities firms specifically. These figures are taken from the 2014 CBR Annual report.

the disclosure obligation for state or commercial secrets, although such omissions from disclosure are made and accepted without any effective statutory safeguards. The exchange does not monitor continuing disclosure obligations by issuers, although CBR states that it is under an obligation to do so. It is important to strengthen the obligation to promptly disclose any matter that might reasonably be expected to affect the value of securities, monitor compliance, and to enforce it by taking appropriate action.

60. Requirements to adopt IFRS are already in place for many companies, with the remaining companies with securities offered to the public, coming into IFRS by 2019, but in practice, the requirement is often observed in form rather than substance. A complex set of provisions in various laws, when taken together, impose a requirement on all listed companies and all companies that publish consolidated financial statements to adopt IFRS. Other companies that issue securities to the public will have to adopt IFRS on a schedule ending in 2019. However, the market perception is that of those currently subject to the IFRS requirement, only those 60–70 companies that seek listings on foreign markets presently comply with this requirement in substance. For all other companies, the general practice is to use RAS as the basis for the narrative and other disclosures in the prospectus, annual reports, and quarterly reports. Formal financial statements, prepared according to both RAS and IFRS are included in the Appendix. RAS standards are described by the CBR as differing from IFRS in a number of ways, mostly with regard to a focus (in practice, although not in principle) on form rather than substance, which could result in very different results, especially at times of volatility in the value of assets. It will be important to ensure full compliance with IFRS in all financial reporting.

Auditors, credit rating agencies and other evaluative services (Principles 19–23)

61. The MoF is at the head of an oversight regime that allows auditing self-regulatory bodies to contribute to, but not take final decisions on, auditing standards and includes enforcement by both the MoF and SROs of auditors. The MoF appoints an Audit Council that is independent from but can consider detailed proposals relating to audit standards prepared by SROs. This independent Audit Council takes final decisions on what to propose to the MoF. As a matter of policy, the MoF accepts the Audit Council recommendations. The Audit Council also approves standards of ethics and independence to be enforced by SROs and the MoF (through the Federal Fiscal and Financial Supervision Service (FFFSS)). SRO enforcement activity is monitored by the MoF. FFFSS enforcement is focused on the auditors of public interest companies (including all listed companies). All auditors and audit firms must belong to one of five competing SROs and, to gain membership, must meet qualification requirements and continuing professional development obligations. Independence provisions in the Law consist largely of descriptions of prohibited relationships. The Code of Ethics and Independence Rules adopt a more principle-based approach. Both the FFFSS and the market agree, however, that it is not easy to enforce the independence rules on the basis of these principles. The market perception is that many audit firms adopt practices that clearly breach the substance of the independence principles but not necessarily the specific provisions in the law. It will be important to enhance the enforcement regime so as to address this problem.

62. A new Credit Ratings Agency (CRA) Law is currently in place but cannot yet be fully enforced and there are no effective requirements for other evaluative services. The new CRA law is reasonably comprehensive and is clearly designed to meet the provisions of the IOSCO Code of Conduct and the IOSCO CRA Principle. All of the requirements relating to registration, disclosure, conflicts of interest, methodology, and internal governance are there. There are some enhancements that should be made with respect to CBR's powers to collect further information from license applicants and the imposition of stronger integrity requirements and overarching recordkeeping provision. CBR is also working on detailed regulations, and these were not all fully in place at the time of the assessment. Therefore, no CRA could register, and the law could not be enforced. CBR does not have a process for identifying new evaluative services that may warrant regulation. It proposes to bring investment advice into regulation, but until it does, there are no specific requirements for analysts employed by brokers. Detailed independence requirements for appraisers (for example, of assets of issuers and collective investment schemes—CIS) are in a Code of Ethics and Independence prepared by SROs, and these were not supplied to the assessors.

Principles for collective investment schemes (Principles 24–28)

63. The market sector is small and does not raise systemic risk concerns; hedge funds and money market funds are not a significant factor. Operators of collective investments schemes require a license from CBR, as do custodians (specialized depositories), the use of which is mandatory. Integrity tests for licensees should be enhanced. Operators and custodians are subject to capital and organizational requirements. Operators are also subject to conduct of business requirements, but improvements should be made. Agents who market shares or units are also subject to licensing. CBR supervises all three groups. The regulatory framework places strong reliance on the specialized depositories to ensure that the operators (management companies) comply with the rules of the funds, the law, and regulatory acts of CBR. Risk-based supervision is being applied in a comprehensive and constructive way. The legal form of CIS is well established, as are the rights of share and unit holders. There is a disclosure regime with mandatory standards for documentation, but improvements should be made.

Market intermediaries (Principles 29–32)

64. All market intermediaries must be licensed and are subject to an evaluation by CBR, but the criteria need to be enhanced and the capital requirements tailored to risk. CBR is the licensing authority (although it cannot impose a license condition). The criteria cover competence, integrity, and financial standing, but the detailed provisions on integrity, in particular, are too narrow and inflexible, giving insufficient discretion to CBR to determine what matters are relevant to the individual and the post in question. The legal entity for which a license is sought must demonstrate compliance with a range of matters including internal controls, RM, and capital. Capital requirements are flat rate and not risk-based. CBR should develop appropriate criteria for judging the adequacy of RM and internal controls, and should be able to make a judgement on the willingness and capacity of the applicant to comply with their obligations. Capital requirements should be risk-based, and CBR should institute early warning reporting for deterioration of capital while enhancing its powers to take action to avoid default. CBR will need to develop a contingency plan for such occurrence.

Principles for the secondary markets (Principles 33–37)

65. Exchanges and non-exchange trading systems are permitted, and both are required to be licensed. Currently there are none in the second category and no applications are pending. The largest exchange, MOEX, has a near monopoly in many of its markets, particularly equities. Exchanges must be fit and proper to conduct operations, maintain capital, and have rules to ensure they conduct fair, orderly and transparent markets. There must be fair access to the markets, and they must comply with CBR requirements for conducting their operations. They also must monitor the conduct of their members and secure compliance of companies admitted to trading with the listing rules; these areas merit closer examination. There are no effective controls or disclosure of on-exchange short selling. More generally, the supervisory system is relatively new and has yet to be fully tested in highly stressed market conditions. Criminal enforcement of breaches of insider dealing and market manipulation is also new and untested. CBR's taking of administrative action in such cases is developing a reasonably successful track record.

SUMMARY IMPLEMENTATION OF THE IOSCO PRINCIPLES

Principle	Grade	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	BI	At the level of the federal laws, the powers and authority of CBR are set out comprehensively and with reasonable clarity. However, the complex interaction of laws, regulations, directions, etc., coupled with frequent changes and very detailed requirements, has resulted in numerous cases of one group of market participants being subject to obligations to which others are not, for no obvious reason. It is doubtful that even with substantial and highly skilled compliance departments, most licensed firms (or their SROs) are able to stay fully compliant on a consistent basis. Investors, too, face substantial difficulties in understanding what their rights are in their relationship with market participants or through ownership of a particular financial product.
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.	PI	Although the independence of CBR is set out in the Central Bank Law and the Board of Directors' functions are limited under that law to certain administrative matters excluding regulatory policy making and enforcement matters, the right of the Ministers of Finance and Economic Development to attend board meetings with a right to participate in discussions and express opinions to be recorded in the minutes' risks creating the impression of possible political involvement in CBR's operational activities.

		There is a lack of legal protection for staff when performing regulatory functions such as carrying out investigations into possible breaches of the law and normative acts of CBR made under it.
Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	BI	<p>Although CBR has control of its operational budget once it has been agreed, the overall size of the budget is established by a decision of the National Financial Board of which the CBR member (the Governor) has one vote among 12. The others are from the Presidential administration, the federation government, and the legislature. Since staff salaries and administrative expenses constitute the major part of the bank's expenses, there is potential for the Presidential administration, federal government, and the legislature to exercise definitive influence over the resources the bank has for regulation and supervision.</p> <p>CBR's costs of regulation are met from income sources other than fees levied on nonbank financial market participants, which go to the government. The retained profit of CBR appears sufficient to enable CBR to meet its responsibilities as a securities market regulator as well as its responsibilities as a central bank and supervisor of banks, insurance companies, and non-state pension funds. It has the necessary powers.</p> <p>Staffing policies and training appear to be well established and resourced, and CBR's initiatives in investor education are well regarded by others working in this area.</p>
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	FI	<p>Among industry participants there was a mix of opinions on the commitment of CBR to "real" consultation. There was a clear majority view that CBR is serious in seeking views of market participants and the public, and that engaging with CBR by responding to public consultations or participation in CBR workshops is worthwhile and can secure improvements in proposed regulatory approaches.</p> <p>CBR has reasonable processes intended to secure procedural fairness and transparency.</p>
Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.	BI	Staff are subject to obligations to maintain high standards in their professional and personal conduct. CBR appears to have made substantial efforts to enable staff to understand their duties and responsibilities as set out in the multitude of laws, regulations, instruction, and orders to which they are subject, and the penalties for breaches, etc. As for the legislative provisions themselves, the assessors were working from translated texts and identified some issues. There may be other ambiguities and weaknesses in the Russian text that the assessors have not identified. Currently, there is a two tier system whereby specific restrictions apply only to a

		limited number of staff. Staff below middle management are subject only to more general provisions in a multitude of laws, regulations, ordinances, etc. There is substantial scope for clarification.
Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.	FI	The Financial Stability Committee (FSC Com) of CBR has a clear focus on nonbank financial entities (NFEs) and systemically important financial market infrastructures, including the dominant central counterparty for securities markets. Within CBR nonbanking sector departments, staff appear to be fully engaged in the work on systemic risk. Although the published Financial Stability Review (FSR) is primarily banking focused, it addresses systemic issues in securities markets when they arise.
Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.	BI	Perimeter review of firms and products appears to be undertaken, and the appropriate sources of information have been identified and utilized. There may be scope for further formalizing the process to ensure that issues are not overlooked when first observed.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	NI	CBR is not sufficiently proactive in identifying and evaluating potential, as distinct from actual and current, conflicts of interest and misalignment of incentives. It lacks a process to facilitate this process. Currently, its responses are primarily reactive. The responsibility for identifying and taking action regarding losses caused by the mis-management of a conflict of interest by a professional market participant is placed on the client, who may be unaware that they have suffered a loss.
Principle 9. Where the regulatory system makes use of SROs that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	NI	<p>The conflict of laws means that CBR cannot enforce the old SRO regulatory regime.</p> <p>The new SRO Law could not be fully enforced at the time of the assessment because of transitional provisions. SRO's primary purpose is defined in the law as being the protection of members' interests, market development and efficiency, not investor protection.</p> <p>There are some gaps in CBR's powers to ensure procedural fairness and effectiveness by SROs.</p> <p>There are some gaps in SRO duties and obligations.</p>
Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers.	FI	<p>CBR has a comprehensive set of powers.</p> <p>There is no overall record keeping obligation imposed on securities firms, although there are extensive and detailed requirements.</p>

Principle 11. The Regulator should have comprehensive enforcement powers.	BI	<p>CBR has a broad range of investigation and sanction powers, and although the level of fines is modest, the fines related to income should be dissuasive.</p> <p>Criminal prosecutions of market abuse offenses are still very rare.</p> <p>Beneficial ownership information may not always be available in practice.</p>
Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	NI	<p>The enforcement regime is found to be not fully effective. The planning of inspections of intermediaries is neither risk based, nor routine and periodic, given that very few scheduled inspections are undertaken.</p> <p>There have been no inspections of the exchanges.</p> <p>Supervision is focused on finding and punishing violations rather than monitoring and enhancing RM.</p> <p>Inspections resources are very limited, with only 250 inspectors for 19,000 nonbank entities across CBR as a whole and used primarily for unscheduled inspections (investigations) rather than routine compliance checks.</p> <p>Periodic reports submitted by intermediaries are concerned mostly with financial information and do not include RM indicators.</p>
Principle 13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	PI	<p>There are powers to share information via the MMoU and other agreements.</p> <p>There is no power to initiate sharing of information on an unsolicited basis.</p> <p>The confidentiality provisions in the Investment Fund Law conflict with the disclosure provisions in the Central Bank Law.</p> <p>Information on beneficial owners may not always be available.</p>
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.	FI	<p>CBR is a signatory to the MMoU and actively meets its obligations.</p>
Principle 15. The regulatory system should	FI	<p>CBR is a signatory to the MMoU and actively meets its obligations.</p>

allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.		
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	NI	<p>There is no effective general ongoing obligation to disclose any material fact that could affect the value of securities.</p> <p>In practice, disclosures of material information, other than the items specifically listed in the law, are rare with only just over 1 percent of disclosures falling into this category, even though this category effectively includes many of the most important disclosures, such as changes in prospects or risks.</p> <p>There is no explicit derogation from the disclosure obligations for state and commercial secrets, and no effective safeguards when disclosures are not made.</p> <p>There is inadequate provision for advertisements outside the prospectus.</p>
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	PI	<p>The necessary protections for majority and minority shareholders are broadly in place.</p> <p>The provisions relating to shareholders acting in concert with others is limited to specified affiliated persons.</p>
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	PI	<p>The legal obligation to apply IFRS rests on complex interaction of laws and is not yet comprehensive.</p> <p>Most companies that are obliged to use IFRS continue to use RAS-based financial statements as the basis of the narrative and other disclosures in prospectuses and periodic reports.</p> <p>RAS do not qualify as internationally accepted standards, because of continued dominance of form over substance in practice.</p> <p>The absence of any examples of companies being required to resubmit accounts because of failure to compile them properly according to IFRS indicates limited enforcement.</p>
Principle 19. Auditors should be subject to adequate levels of oversight.	FI	<p>The oversight regime is headed by the MoF and Audit Council as public interest bodies, independently of the auditing profession.</p>

Principle 20. Auditors should be independent of the issuing entity that they audit.	PI	<p>The independence principles defined in the Code of Ethics and Rules of independence of auditors are not yet fully implemented in practice.</p> <p>There are no requirements that the governance arrangements of a public company should result in effective oversight of the appointment of auditors by the risk committee of issuer.</p> <p>There are no requirements to disclose the resignation of an auditor. There is no mandatory requirement for rotation of auditors or the senior officials engaged on an audit.</p>
Principle 21. Audit standards should be of a high and internationally acceptable quality.	FI	International Audit Standards are, in effect, applied to public companies in the Russian Federation.
Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.	NI	<p>The new CRA law is comprehensive and broadly meets IOSCO requirements.</p> <p>However, there are a number of regulations that had yet to be issued at the time of the assessment, and so the law could not be effectively implemented, and there were no CRAs yet registered.</p>
Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.	NI	<p>There is no process for identifying areas of activity that may fail to be regulated under this principle.</p> <p>There are insufficient provisions to address conflicts of interest of analysts employed by brokers.</p> <p>Detailed provisions on appraisers contained in the SRO Code of Ethics have not been supplied to assessors.</p>
Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a CIS.	PI	<p>Managers and selling agents are licensed by CBR to the standards applied to all professional market participants. As such, integrity tests should be enhanced.</p> <p>Risk-based supervision has been applied in a comprehensive and constructive way, as lessons learned by CBR as to RM and internal control practices in well-run fund management companies (MC) are being used to increase standards in less well-run MCs.</p>

		Some detailed rules of dealing in securities by fund managers are missing.
Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	FI	The legal forms and structures of CIS and investor rights are set out in the law and mandatory model fund rules, which are the equivalent of a prospectus or offering document. The custodian (specialized depository—SD) has onerous responsibilities to ensure that the manager operates the fund within the law, CBR regulatory acts, and the fund rules. The depositories are licensed by CBR and are subject to detailed regulation of their structure, operations, and regulatory reporting requirements.
Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a CIS for a particular investor and the value of the investor's interest in the scheme.	NI	Disclosure requirements for unit investment funds (UIFs) are reasonably comprehensive, and CBR has the right to demand the retraction of disseminated information which does not satisfy the requirements of the Investment Funds Law or regulatory acts of the CBR; to demand dissemination of corrected information; and to prohibit dissemination. There is, however, no overarching general obligation on MCs to provide a wide range of current information in the fund rules or elsewhere which would enable potential investors to make an informed investment decision; nor an obligation to provide that information in a way that an ordinary person will understand.
Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a CIS.	FI	Valuation of the NAV of funds appears to be carried out to a high standard and with effective checks and balances. Procedures for dealing with a fund which is forced to suspend redemptions appear satisfactory, and the powers of CBR in this situation, and if a winding up proves necessary, appear sufficient but are untested.
Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.	BI	Hedge funds are not a source of potential or actual systemic risk in the Russian Federation, and as such intensive regulation as set out in the Key Questions to this principle is not required. Furthermore, hedge funds and hedge funds managers are regulated at the same level as other funds targeted at qualified investors.
Principle 29. Regulation should provide for minimum entry standards for market intermediaries.	PI	The licensing power is exercised carefully and with thorough examination of applications. However, there is no regulation of investment advisers (and they are not required to submit advice only through licensees). The license criteria are not comprehensive, especially with regard to integrity. There is no power to impose a license condition.

		There is no general requirement on a licensee to report any change that might affect their suitability to be licensed.
Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	NI	<p>Capital requirements are not sufficiently tailored to the quantum and nature of risks, nor to risks from outside regulated entity.</p> <p>There is no liquidity requirement for intermediaries.</p> <p>There is no requirement to maintain knowledge of capital at any time and calculate capital daily.</p> <p>There is no requirement that auditors should check that the amount of capital is sufficient to match the risks faced by the intermediary.</p> <p>There is no requirement to report a deterioration of capital to CBR.</p> <p>CBR powers to intervene to protect investors are limited (unless a broker is, in effect, in default, when the Insolvency Law provisions can be used).</p>
Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.	NI	<p>There are some detailed requirements on client asset segregation, internal controls, and RM.</p> <p>There are no overriding obligations to act with due care and diligence with respect to clients, to give priority to client interests, or to have systems and controls to protect the integrity of the dealing process, or the integrity of the market.</p> <p>There is no requirement to have systems and controls that ensure the fair, honest, and professional treatment of clients.</p> <p>There is no obligation to conduct a risk assessment, tailor policies and procedures to that assessment, have information systems to check effectiveness of controls, to review effectiveness annually, or to re-evaluate risk annually.</p> <p>There is no effective overriding obligation to identify and prevent or manage and disclose conflicts of interest and, if necessary, refuse to act.</p> <p>There is no overriding obligation to segregate duties, where necessary to avoid internal conflicts of interest.</p> <p>There is no overriding obligation to collect sufficient information from a client to ensure services are suitable for the client's risk appetite and objectives.</p>

		<p>There is no obligation to disclose enough information to enable an investor to make an informed decision.</p> <p>There is no specific requirement for a client to be provided with a written client agreement that includes fees and charges.</p> <p>There is no effective requirement on an investment manager to segregate client money.</p> <p>There are insufficient safeguards to protect clients of brokers who use client money for their own purposes.</p> <p>There are insufficient provisions for requiring the intermediary to identify the client and beneficial owner of the account.</p> <p>Client money accounts are reconciled only monthly, and client assets reconciled only quarterly, and this is insufficient.</p> <p>It is not appropriate to place primary responsibility for compliance with the law and regulations on the compliance officer; this should be on the management of the intermediary.</p>
Principle 32. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	NI	<p>There are powers available to deal with an intermediary in default in the Insolvency Law, and these are sufficient once the conditions are met to make them available.</p> <p>There is no documented contingency plan for dealing with failure of an intermediary.</p> <p>There are no early warning systems for potential default.</p> <p>There are only limited powers to take action to protect investors prior to default by intermediary.</p>
Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	FI	<p>As is typical of most jurisdictions, applications to open a new exchange or non-exchange trading system are rare events. From discussion with exchange supervision staff at CBR, it was apparent that the licensing of the merged Moscow Interbank Currency Exchange (MICEX) and RTS was thorough and skillful and with an awareness of significant issues.</p>
Principle 34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair	PI	<p>Although the elements of supervision as set out in this principle appear to be met as far as this can be achieved from the obligation on exchanges to provide substantial ongoing documentation flows to CBR, the system of supervision has yet to be rigorously tested by an onsite inspection of MOEX, a period of intense stress in the markets, the unexpected insolvency of a major listed company, or the failure of one or more large members.</p>

and equitable rules that strike an appropriate balance between the demands of different market participants.		
Principle 35. Regulation should promote transparency of trading.	FI	There appear to be no obvious omissions in the transparency regime on MOEX's markets. The unusual ability of the exchange to have developed markets in products largely traded OTC in other countries such as corporate bonds, foreign exchange, and repos means that there is more transparency in these markets than is typical elsewhere. The absence of dark pools, even informal ones such as broker crossing networks, means that a factor which elsewhere complicates initiatives to maintain or increase levels of transparency in equity markets, and limit the creation of two tier markets, is missing. However, High Frequency Trading (HFT) is a significant factor in equity trading.
Principle 36. Regulation should be designed to detect and deter manipulation and other unfair trading practices.	BI	The Law and the regulatory and technological resources appear to be in place for an effective regime to detect, deter, and punish insider dealing and market manipulation. It is a new law, and no cases have yet come to court to make a judgment as to their effectiveness. While the fines are unlikely to be dissuasive, the loss of three years' salary should be. The prison sentences and other sanctions should have a high deterrent effect, if persons contemplating insider trading or market manipulation consider that there is an unacceptably high possibility of being detected and convicted in a criminal court. CBR is developing a reasonably good track record in detecting breaches and taking administrative action.
Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	PI	<p>With one exception, the regime to monitor large exposures appears comprehensive, well-planned, and well-managed. It uses multiple data sources, mostly in real time. Flows of relevant information to the appropriate departments within CBR work well and should generate warning signals in time for CBR and NCC to take appropriate action. Financial Stability Department's (FSD's) threshold for concern—a single exposure which equals or exceeds 100 percent of an entities' own funds—is too high. Recent improvements to the bankruptcy law and the associated clearing law have been formally recognized internationally.</p> <p>There is a lack of effective controls on short selling of equities on MOEX, including the absence of a surveillance regime, and no mechanism for providing information on short selling to market participants or CBR. The NCC takes effective measures to protect itself from exposure to naked short selling by MOEX members and their clients, which is one necessary element of the IOSCO requirements, but it is not sufficient.</p>

Principle 38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective, efficient and that they reduce systemic risk.	Not assessed	
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Note: Fully Implemented (FI), Broadly Implemented (BI), Partly Implemented (PI), Not Implemented (NI), Not Applicable (NA).

RECOMMENDED ACTION PLAN AND AUTHORITIES' RESPONSE

Table 7. Recommended Action Plan to Improve Implementation of the IOSCO Principles	
Principle	Recommended Action
Principle 1	<ul style="list-style-type: none"> The draft Guidelines for the Development and Stability of the Financial Market of the Russian Federation for the Period of 2016–18 has, as one of its goals, “creating conditions for the growth of the financial industry.” It has identified as critical to the achievement of that goal “enhancing financial market regulation, inter alia through proportional regulation and optimization of the regulatory burden on financial market participants.” It would be consistent with that goal for CBR, perhaps in conjunction with the MoF and industry representatives, to set up a program with the objective of achieving a substantial simplification of the regulatory framework while retaining and enhancing those elements of regulation, supervision, and enforcement which are necessary to achieve the other goals set out in the draft Guidelines, namely “improving the living standards for the Russian population through the use of financial market instruments;” and “facilitating economic growth through granting the competitive access of Russian economic agents to debt and equity financing.”
Principle 2	<ul style="list-style-type: none"> The authorities should consider measures to secure immunity for CBR staff in the case of decisions properly made on the basis of due diligence. Given the other opportunities for consultation between Government and CBR at Governor and Board level, as set out in the CBR Law, the authorities should consider whether the right of the Ministers of Finance and Economic Development to attend Board meetings and express recorded opinions is necessary or appropriate.
Principle 3	<ul style="list-style-type: none"> The authorities should consider whether the process by which a very substantial proportion of CBRs’ operational budget is set by the executive and legislature of the Russian Federation in the National Financial Board is consistent with true operational independence of CBR in the performance of its supervisory and regulatory responsibilities.

Principle 4	<ul style="list-style-type: none"> • CBR should keep its consultation process under review to ensure that it engages the willing support of the nonbank licensees for its development of more effective regulation of the financial markets sector.
Principle 5	<ul style="list-style-type: none"> • CBR should review the multitude of legislative and regulatory requirements to which staff are subject to remove any ambiguities and with the longer-term aim of codifying them in a comprehensive Code of Professional Ethics. There is substantial scope for clarification. • The currently two-tier system whereby specific restrictions apply only to a limited number of upper-level staff should be reviewed.
Principle 7	<ul style="list-style-type: none"> • Further formalizing the process of perimeter review might include appointing a senior manager and staff with specific responsibility and appropriate reporting lines for the topic. Consideration should also be given, if not already in place, of providing specialized training for the Territorial Units of the bank to enable them better to recognize Ponzi schemes and other outright fraudulent practices.
Principle 8	<ul style="list-style-type: none"> • The assessors have noted the difficulties in drafting legal provisions stating general principles of behavior, but strongly urge the authorities to seek a solution which would enable the Russian regulatory framework to move closer to international standards regarding an effective framework which both requires and assists licensees to identify, manage, and mitigate conflicts of interest and misaligned incentives that arise in their businesses.
Principle 9	<ul style="list-style-type: none"> • Provisions in previous laws relating to SROs that conflict with provisions in the new law should be repealed. • The new SRO Law should be amended to provide that: <ul style="list-style-type: none"> ○ the primary purpose of SROs as being to promote high standards of conduct to protect investors and promote fair markets; ○ an explicit condition of registration of an SRO should be the ability to demonstrate to CBR that the SRO has the willingness and capacity to provide adequate standards of professional behavior and investor protection; ○ an SRO should adopt provisions that prevent any member of the SRO, or any employee from abusing their position to gain unfair competitive advantage; ○ an SRO's internal rules should include provisions on procedural fairness that match those of the CBR itself, and a prohibition on the inappropriate use of information, for example for personal gain; ○ an SRO's internal rules should ensure that all similarly situated members and applicants should be treated equally; ○ the membership criteria for the new SROs should not constitute a barrier to entry to the securities or fund management business; ○ an SRO should be required to submit its internal rules to CBR for approval, and CBR should be able to approve, deny approval, or insist on changes to the SRO's internal rules, where necessary, to ensure that they match appropriate standards of fairness, effectiveness, and professionalism; ○ an SRO should be required to keep records, for a minimum of five years, which demonstrate that it is complying with its charter and its statutory responsibilities, and which record the operation of its functions; ○ CBR has the power to conduct onsite inspections of SROs;

	<ul style="list-style-type: none"> ○ the power of CBR to collect information from SROs overrides any confidentiality duty imposed by the SRO Law or any other statute; ○ CBR has the power to approve, deny approval to, or insist on changes to SRO internal rules; ○ CBR has the power to conduct inspections of SROs and should state explicitly that the duty to disclose matters to CBR overrides any duty of confidentiality to members. ● CBR should develop a new supervisory regime with SROs, where basic standards replace (not add to) existing regulations, and all supervisory tools are used. ● CBR should develop an oversight methodology for monitoring SRO activity.
Principle 10	<ul style="list-style-type: none"> ● The Securities Law, Investment Funds Law, and Organized Trading Law should include an overriding record keeping obligation that requires all securities businesses to keep such records as would be necessary to demonstrate their operation of their business, to demonstrate compliance with the law and regulations, to document their relations with clients and third parties, and to keep such records for five years.
Principle 11	<ul style="list-style-type: none"> ● CBR should seek an amendment to the Anti-Money Laundering (AML) Law so that a person subject to the relevant obligations should: <ul style="list-style-type: none"> ○ Always ask a natural person if they are acting on their own behalf or on behalf of another; and ○ Refuse to act if they are unable to identify the beneficial owner of a legal entity. ● CBR should consider reviewing the powers in Article 11 of the Investor Protection Law and seeking amendments as appropriate so as to ensure that they are capable of being used in practice.
Principle 12	<ul style="list-style-type: none"> ● CBR should devote sufficient resources to the inspection team so as to be able to conduct a risk-based, or routine/periodic scheduled inspection program. ● CBR should commence a regular inspection program of the exchanges. ● The Securities Law should be amended to place specific responsibility for ensuring compliance with regulatory obligations on management. ● The internal controls regulation should be amended to focus on the essential elements of an internal control system rather than just the detailed provisions for the appointment and functions of the compliance officer. ● CBR should adopt an approach to enforcement that focuses on the risks to the objectives of securities regulation, identifies the key measures to mitigate those risks, and uses all supervisory tools to ensure compliance with those regulatory requirements. ● CBR should develop the periodic reporting requirements so as to gain more information relevant to the adequacy of RM and compliance by securities firms. ● CBR should develop a protocol for mounting investigations into market offenses so as to avoid the risk of "tainting" evidence before a full criminal investigation takes place.
Principle 13	<ul style="list-style-type: none"> ● The CBR Law should be amended to enable CBR to provide confidential information to a foreign regulator on an unsolicited basis. ● The Investment Funds Law should be amended to provide an exception to the commercial secrets provision to allow disclosure where required by law.
Principle 16	<ul style="list-style-type: none"> ● The Securities Law should be amended so that it:

	<ul style="list-style-type: none"> ○ includes an effective provision that requires the disclosure of any material fact that would reasonably be expected to affect the price of a security or the decision to buy or sell that security; ○ permits derogations from the disclosure obligations for state and commercial secrets but imposes safeguards, which include CBR powers to approve or deny approval to deferral of disclosure and appropriate trading restrictions to protect market integrity, as well as powers to require immediate disclosure when obligations are not met; ○ no longer includes the 50 detailed matters for disclosure from the Securities Law, thereby reinforcing the primacy of the overriding obligation to disclose all material facts; and ○ gives CBR specific powers to require issuers to make disclosures when material events have occurred (or CBR discovers that they may be about to occur), but the issuer has failed to meet its disclosure obligation. ● The 50 detailed matters listed in the Disclosure Regulation should exclude routine events which would not affect the price of a security (such as the announcement of a general meeting) and include a material change in prospects, a significant change in risks, a change in the economic circumstances of the country or region in which the issuer does most of its business, a significant change in the trading environment, the signing of a major new contract, the loss of a major contract, a major physical or weather event that affects the continued operation of the company, a significant change in the line of business, a decision to acquire or sell significant assets, or any other major event which is likely to affect the value of the company's assets, or its ability to continue to make profits. ● The Investor Protection Law and the Law on Advertising should deal more comprehensively with advertisements so as to ensure that advertisements issued in connection with a public offer should be issued only by the issuer or advisers acting under the issuer's authority, should only contain information that is true and not misleading, should refer to the prospectus. and should be subject to approval by CBR. ● CBR should discuss the simplification of the disclosure regime with the private sector to make it more comprehensible and enforceable.
Principle 17	<ul style="list-style-type: none"> ● CBR should seek an amendment to the Joint Stock Company Law to: <ul style="list-style-type: none"> ○ Extend the requirements relating to shareholder disclosures and takeovers to those reaching the specified thresholds when acting in concert with any person; ○ Extend the requirements for information to be provided for General Meetings so as to include full information on the consequences of decisions proposed on the agenda; and ○ State explicitly the rights of shareholders to receive remaining assets after liquidation, in proportion to the shareholdings (in relation to all assets and not just in respect of dividends credited but not paid).
Principle 18	<ul style="list-style-type: none"> ● CBR should continue its program of progressively obliging public companies to publish financial statements according to IFRS. In addition, CBR should require those companies that are subject to a requirement to publish accounts according to IFRS to use the IFRS accounts as the basis for the narrative and other disclosures in the prospectus and quarterly reports.

	<ul style="list-style-type: none"> • The MoF should consider amending the agreement with the National Organization to give MoF formal oversight powers to enable it to check on the internal processes of the National Organization and thereby ensure they are sufficiently transparent. Such a provision should be included in future agreements with organizations that may win the tender to act as the independent adviser on accounting standards in the future.
Principle 20	<ul style="list-style-type: none"> • The Auditing Law (or other legislation as appropriate) should be amended to include: <ul style="list-style-type: none"> ○ A general provision prohibiting financial business, corporate, and personal relations between an auditor or audit firm and the client and any other relationships or behavior that might threaten or reasonably appear to threaten independence; ○ A general provision that prohibits the provision of any non-audit services to an audit client, where such services may be of a nature or scale that would compromise or appear to compromise the independence of the auditor; ○ Provisions requiring governance arrangements that ensure that the selection of auditors and the oversight of auditor independence is, in the case of public issuers, carried out by a body independent of management; ○ A requirement to disclose the resignation, replacement, or removal of an auditor. • The Audit Council should ensure that audit and ethical standards include the requirement that internal quality controls directly address independence, and that there are mandatory measures to require the rotation of individual auditors if not audit firms, so as to safeguard independence. • The MoF should increase the priority given to independence in substance as well as form, when conducting inspections.
Principle 22	<ul style="list-style-type: none"> • CBR should complete the process of writing regulations, so that the law can come into effect. • The CRA Law should be amended to include: <ul style="list-style-type: none"> ○ A general record keeping requirement that is broad enough to ensure that all appropriate records are kept to demonstrate the compliance of the CRA with the regulatory requirements, the operations of the business and the practical implementation of rating methodology); ○ The power for the CBR to require an applicant for registration as a CRA to provide additional information; ○ An obligation on CRAs to maintain sufficient resources to be able to apply the methodology with all relevant information rigorously and robustly; and ○ An expanded integrity test, with a broader disclosure requirement and the discretion of CBR to consider whether the matters disclosed are relevant.
Principle 23	<ul style="list-style-type: none"> • CBR should create regulations that specifically address the potential conflicts of interests of analysts when introducing a regulatory regime for advisers. • CBR should review the ethical standards of the SROs for appraisers to ensure that all the requirements of this principle are met.
Principle 24	<ul style="list-style-type: none"> • While continuing to search for customers carrying out improper transactions, with or without the knowledge of the licensee, onsite inspectors should be equally engaged in seeking evidence of a firm treating its clients unfairly, such as by selling funds or other products not suitable for the client's risk profile, or where a less expensive (but lower commission generating product) would meet the client's need equally well or even better. As retail participation in financial markets increases, mis-selling of

	<p>financial products is likely to increase, and this will damage the confidence of new investors in financial markets.</p> <ul style="list-style-type: none"> • Increase the number of annual planned onsite inspections of MCs and SDs. • Introduce rules covering best execution and due diligence. • Introduce more comprehensive integrity tests for individuals in key positions in MCs.
Principle 25	<ul style="list-style-type: none"> • Although a SD must be independent of the MC of a UIF, it is able to be a company within the same group as the MC. There is potential in these circumstances, despite the current regulation of the activities of SDs, for collusion or a lack of care to occur. A mechanism to mitigate this risk might be to assign, within the risk-based supervisory framework, a High Risk or “red zone” rating to SDs in this position and submit them to the highest intensity of SD supervision. Alternatively, the Investment Funds Law could be amended to secure actual independence of the SD.
Principle 26	<ul style="list-style-type: none"> • CBR should continue to explore ways, within the constraints imposed by Russian law, to establish general or overarching requirements on MCs to provide a wide range of current information in the fund rules and elsewhere which will enable potential investors to make informed investment decisions; and to provide that information in a way that an ordinary person will understand.
Principle 27	<ul style="list-style-type: none"> • There has not been a failure of a fund for a long time, and the relevant laws and regulatory acts have changed, some repeatedly, in recent years. CBR might wish to consider running an exercise (“war game”) to test the current legal and operational position against a hypothetical failure of a fund or group of funds.
Principle 28	<ul style="list-style-type: none"> • The further development of hedge funds, and funds which, while not being formally categorized as hedge funds, can borrow to invest and thus can be highly leveraged, should be closely monitored by CBR with a view to subjecting them to more intensive supervision should they begin to demonstrate systemic risk characteristics.
Principle 29	<ul style="list-style-type: none"> • The Securities Law and regulations should be amended so as to: <ul style="list-style-type: none"> ○ Expand the fitness and properness criteria for (and matters to be disclosed by) senior managers and owners especially with respect to integrity; ○ Give CBR the discretion to determine the relevance of the disclosures when considering whether or not to grant permission to take up a post; ○ Give CBR discretion to judge the adequacy of the organization, and governance, including the adequacy of the RM and internal controls of a license applicant; ○ Impose a general obligation on a license applicant to disclose any matter that might reasonably affect CBR’s judgement as to the suitability of the applicant to undertake securities activity and extend this to licensees so as to create an obligation to disclose any matter that might reasonably be supposed to affect a decision as to whether they should retain a license or continue to act as manager or owner (as appropriate); ○ Give CBR the power to grant a license with conditions, or amend a license to impose terms and conditions as appropriate; and ○ Bring investment advice into regulation. • CBR should develop criteria to assist it in making the qualitative judgements recommended here.
Principle 30	<ul style="list-style-type: none"> • The new regulation on risk-based capital that CBR is contemplating should:

	<ul style="list-style-type: none"> ○ Set capital requirements that are based on the full range of risks to which a professional securities market firm is subject, taking account of the nature, scope, and scale of its activities, and require that capital be maintained at all times; ○ Impose a liquidity requirement that would ensure that a professional securities firm could absorb some losses and wind down the business in an orderly manner; ○ Create an obligation on a professional securities firm to report a deterioration in excess capital (i.e., the capital held in addition to the minimum requirement) of 50 percent since the last report; and a further obligation to report to CBR if their capital falls below 120 percent of the minimum; ○ Require securities firms to make a daily calculation of capital and place this on the file so that CBR and auditors can select days at random to check that such calculations are being undertaken properly; ○ Set a deadline for the submission of annual audited accounts by professional securities firms; and ○ Set a requirement on securities firms that they must get an annual opinion from their auditors on whether their capital is sufficient for the full range of risks.
<p>Principle 31</p>	<ul style="list-style-type: none"> ● The Securities Law should impose the following obligations on securities firms, in each case, with overall provisions supported by some detail giving clear information about what is required to ensure that the overall obligations are implemented effectively: <ul style="list-style-type: none"> ○ To act with due care and diligence in the interests of a client, to place the interests of the client above its own, and to have systems and controls that ensure the integrity of its dealing practices and the fair, honest, and professional treatment of clients; ○ The management to have full responsibility for complying with legal and regulatory obligations; ○ The management to undertake a risk assessment of its business, to devise policies and procedures that address those risks, to train staff in those ○ procedures, to have an information system for assessing effectiveness of those policies and procedures, to review the effectiveness at least once a year, and to reassess the risks at least once a year; ○ An investment manager to hold client funds in a segregated account; ○ All securities firms to identify and prevent, or manage conflicts of interest, by disclosure, internal organizational barriers, or by declining to act;

	<ul style="list-style-type: none"> ○ All securities firms to ensure that there is appropriate segregation of duties where necessary to prevent unmanageable risks of conflicts of interest, undetected errors, breaches of internal controls, or abuse more generally; ○ All securities firms to obtain sufficient information about the client's circumstances and objectives to enable them to provide appropriate services and advice; ○ All securities firms to refuse to accept clients where the reasonable and affordable measures have not identified the beneficial owner and to establish in each case if a natural person is acting on his or her own behalf or on behalf of another; ○ Those firms that hold client money to have effective protection for those assets including segregation and a requirement to reconcile client money in the bank accounts with the internal records on a daily basis; and ○ Those firms that hold client assets to reconcile client assets with internal accounting records weekly for the high-intensity trading client, and monthly for all other clients, except those who do not trade for three months, whose reconciliation should be quarterly. ● CBR should amend regulations to impose the following obligations: <ul style="list-style-type: none"> ○ To have systems and controls to limit the use of client money in the securities firm's own interests (to circumstances where it provides scope for covering temporary and minor shortfalls in the client account), to give prominence to this matter in the client agreement, and to explain the risks to the client; ○ To identify all clients and the beneficial owners; ○ To provide a client with a written agreement with certain specified contents, such as fees and charges; and ○ To give a client enough information to make an informed investment decision.
Principle 32	<ul style="list-style-type: none"> ● The Insolvency Law should be amended to enable CBR to appoint a provisional administrator if it thinks such action is necessary to protect investors or safeguard market stability from the consequences of a default. ● CBR should review the powers of the provisional administrator to ensure that they are sufficient to enable it to: <ul style="list-style-type: none"> ○ Restrict activities by the intermediary; ○ Move client accounts to another intermediary; and ○ Apply other available measures intended to minimize customer, counterparty, and systemic risk in the event of intermediary failure, such as customer and settlement insurance schemes or guarantee funds. ● CBR should draw up a detailed plan of the specific actions it would take in the event of a failure, including the names and contact details of those who would take the relevant decisions, contact details of the relevant people in other agencies, draft press releases and statement to investors, check lists of steps to be considered to exercise legal powers and protect investors, lists of the necessary physical facilities that may be required, names of possible administrators, and other relevant matters. The plan should be tested from time to time in a trial exercise.
Principle 33	<ul style="list-style-type: none"> ● In considering issues which arise in its ongoing supervision of MOEX, the exchange supervision team should look carefully at the exchange's record of disciplining members and listed companies. The current approach has elements which, while it may be effective in the context of a Russian market with few retail investors, are difficult to reconcile with good international practice.

Principle 34	<ul style="list-style-type: none"> The upcoming first inspection of MOEX will be an important stage in CBR's development as a securities market regulator, and it will be critical that the inspectors have the necessary skills and will have been fully briefed by the offsite exchange supervision team to carry out their task efficiently and knowledgeably.
Principle 35	<ul style="list-style-type: none"> Although dark pools and informal trading systems do not exist in the Russian market currently, some brokers are internalizing trades in overseas markets and CBR should remain alert for any indications that this practice is being adopted domestically.
Principle 36	<ul style="list-style-type: none"> In order to enhance the cooperation between the Department for Market Manipulation and Division F over the longer term, the two parties could consider whether there are benefits in developing a MoU which sets out the responsibilities and expectations of both parties. The expectation must be that the work load will increase as knowledge and expertise and technical and analytical resources to detect violations increase. Given that market manipulation is now a criminal offense, the exemptions in the Insider Trading Law have particular importance. As is the case in the EU under the Market Abuse Directive and in other jurisdictions, such as Japan and the United States, where the equity and bond markets are an important source of debt and equity capital, CBR should review the current regulation and consider what improvements are necessary to impose suitable limits on trading activities in order to ensure that investors' interests are adequately protected.
Principle 37	<ul style="list-style-type: none"> CBR should work with MOEX to research good practice on the regulation and disclosure in other markets and adopt measures best suited to the Russian market, while being consistent with international standards. With one exception the regime to monitor large exposures appears comprehensive, well-planned, and well-managed. It uses multiple data sources, mostly in real time. Flows of relevant information to the appropriate departments within CBR work well and should generate warning signals in time for CBR and NCC to take appropriate action. FSD's threshold for concern—a single exposure which equals or exceeds 100 percent of an entities own funds—is too high and should be reduced, possibly to a maximum of 25 percent.

A. Authorities' Response to the Assessment

Introduction

66. The CBR extends its appreciation to the representatives of the International Monetary Fund who worked closely and remotely on the assessment of implementation of the IOSCO Objectives and Principles of Securities Regulation in the Russian Federation.

67. Financial sector surveillance conducted by the International Monetary Fund represents a distinct opportunity for understanding the key linkages that affect the stability and vulnerability of the Russian financial sector. The results of the mission have deepened the CBR's understanding of the improvements to be made, helped to articulate policy recommendations, and could be used for better discussions with market participants, which are also called for to provide support for policy and institutional changes.

Principle-by-Principle Response

Principle 6

68. We suggest rephrasing the summary passage referring to Principle 6 in the following way: The FSR addresses systemic issues in all segments of the financial markets, including securities markets, when they arise, and these issues are given appropriate focus and analysis. Within the CBR, nonbanking sector departments' staff appears to be fully engaged in the work on systemic risk. While FSC com is responsible for the assessment and analysis of systemic risks and the stability of the financial system, it also has a special focus on NFIs and systemically important financial market infrastructure.

Principle 9

69. It is significant to reflect that on March 10, 2016, seven SROs were registered under the new SRO Law, and moreover four of them are SROs of professional securities firms. CBR thus suggests eliminating the inconsistencies in the text of Principle 9 implementation assessment.

70. Furthermore, the assessment states that the CBR must approve basic standards no later than three months after the first SRO is registered. This statement is not accurate. Rather, the CBR sets a list of basic standards not later than three months after the first SRO is registered (Article 33(9) of the SRO Law).

Principle 12

71. As the grade for Principle 12 ("The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program") was downgraded from *partly implemented* to *not implemented*, we suggest taking into consideration the comments below.

72. Please consider that the grade *not implemented* involves the identification of serious deviations from the criteria, and that this judgment is not substantiated. Specified criteria regarding the competencies of the Chief Inspection are implemented without any significant deviations, and therefore are partly implemented.

73. Moreover, please take into consideration the data on the number of inspections: in 2014 the Chief Inspection carried out 37 onsite inspections of professional securities market participants, including 9 (24 percent) unscheduled inspections. In 2015, 27 onsite inspections of professional securities market participants were carried out, including 4 (15 percent) unscheduled inspections. As regards asset management companies, the Chief Inspection carried out 43 onsite inspections, including 36 (84 percent) unscheduled inspections in 2014, and 25 onsite inspections, including 13 (52 percent) unscheduled inspections in 2015.

74. CBR also suggests taking into account the following observations:

- Inspections are in general conducted at the suggestion of the off-site team and based on facts regarding the deterioration of the financial position, breaches of regulations, complaints by clients and the federal authorities, profile, exposure and concentration of risk, business transparency, among others.
- CBR has adopted the practice of coordinated onsite inspections of financial groups (including those, which are not institutionalized as financial groups). This tool allows CBR to identify risks taken by the groups (individual participants of the groups). Coordinated inspections allow CBR to uncover procedures used to mask the risks taken by the group, and thereby improve the transparency of financial activities and improve market discipline.

75. Concerning the description of the switch to the risk-based principles, is important to consider the points made below.

76. In 2014–15, the Chief Inspection carried out onsite inspections of professional securities market participants initiated by the Securities Market and Commodity Market Department implementing risk-based supervision. There were mainly inspections of relatively small professional securities market participants about which there was substantial negative information on their financial statement or activities.

77. During most of these onsite inspections, violations were discovered, including of the requirements of the legislation, as well as the absence of assets or their significant overvaluation, typically associated with the use of “structured” operations to comply with capital structure requirements, and with the investment of funds in financial instruments of dubious quality, and with an increased risk of deliberate substitution of high-quality and liquid assets.

78. The Chief Inspection, during onsite inspections of the activities of professional securities market participants, in particular evaluates the quality of internal control and risk-management systems for compliance. In most of the inspected professional securities market participants, no systems had been organized for internal control and RM, and corporate governance was not compliant with international principles. These facts were considered to be violations of the requirements of the legislation. The assessment of the quality and the level of implementation of declared procedures of internal control systems, RM, and corporate governance in these professional securities market participants had no chance to be carried out due to total absence of the subject for assessment. Approaches to implementation of this practice are constantly improving. Examples of best practices were reported to Chief Inspection employees during training sessions.

79. The report of the mission does not accurately mention that a final report of violations, together with an agreed rectification program, is handed to the regulated entity on the departure of the inspection team. The final report must not include an agreed rectification program. Moreover, monitoring of the elimination of violations found during the onsite inspections is not within the competence of the Chief Inspection.

Principle 16

80. Principle 16 states that there should be full, timely, and accurate disclosure of financial results, risk and other information that is material to investors' decisions. This principle was assessed as “not implemented” even though Russian legislation provides for all major requirements for prospectus, financial statements, and disclosure of material facts. This information was provided during the assessment and is mentioned in the report. The legislative provisions are set in Federal Law No. 39-FZ “On the securities market” (Article 24(4), Article 30, 30(2), 30.1), and in the federal law “On joint stock companies” (Chapter 13). Detailed disclosure requirements for securities issuers are set out in the Regulation of the Bank of Russia dated December 30, 2014, № 454-P. These requirements are set in line with IOSCO International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers, International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers, Principles for Periodic Disclosure by Listed Entities and Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities, and are enforced by CBR.

81. As for the main shortcomings in the implementation of the Principle 16 mentioned in the report, the following points should be considered:

Advertisements during the securities offering

82. Current Russian legislation provides for the necessary legal mechanisms to ban offering advertisements before a prospectus is published. There is also a requirement in the Securities Law that prohibits unfair and inaccurate advertisements as well as advertisements missing any material information concerning the offering. CBR will take into account the recommendation to require prior approval of securities advertisements by CBR, which is currently missing.

Material facts disclosures

83. The Report does not take into account that Russian legislation requires companies to disclose any material fact potentially able to influence the price of the security issued by such company. Specifically, Article 30(13) of the Securities Law defines the material fact as any event which may cause a substantial change in securities' price. As provided for in Article 30 (4), such material events are to be disclosed. Moreover, the CBR has the power to require the issuer to make such disclosure in case of failure through a CBR order.

84. The list of events in Article 30 (14) of the Securities Law covers most possible situations in which meaningful disclosure is necessary for investors, while the general obligation to disclose any material fact that could affect the value of securities set out in Article 30 (4)(13)(14) covers all the rest. Many of the examples of events cited in the report as not covered by the list are actually covered (that is, signing of a major new contract, the loss of a major contract, significant change in the line of business, a decision to acquire or sell significant assets), while others are not applicable in the Russian tradition—such as profit warnings—as many companies consider only an approved financial statement as a valid document due to disclosure.

Absence of explicit derogation from disclosure obligations and safeguards giving CBR the power to require advance notice of any decision to delay or abstain from disclosures of material facts

85. We find the assessors' statement that there is explicit derogation from the disclosure obligations for state and commercial secrets to be arguable as there are general provisions that all essential information is to be disclosed, and if the information is not disclosed, then the issuer must provide the reason for doing so. When state and commercial secrets shall not be disclosed in accordance with the corresponding laws, and when the issuer refrains from such disclosure of state or commercial secrets, the issuer must nonetheless disclose that this information was not disclosed because it constitutes a state or commercial secret. The recommendation to provide CBR with the power to require advance notice of any decision to delay or abstain from disclosures will be considered.

86. Overall, CBR does not agree with the "not implemented" assessment for this Principle. CBR believes that major safeguards requiring full disclosure that enables investors to take informed investment decisions are implemented in the Russian legislation. There are certain shortcomings in the disclosure regime. However, in CBR's opinion, they are not of a gross nature and do not justify downgrading the previous FSAP assessment, which was "partially implemented," especially considering that there were no changes in the legislation that weakened the disclosure regime.

Principle 17

87. CBR does not agree with the downgrade from "broadly implemented" to "partly implemented" for Principle 17 ("Holders of securities in a company should be treated in a fair and equitable manner"). Russian legislation in fact provides for all major safeguards aimed at implementation of the principle, according to which holders of securities in a company should be treated in a fair and equitable manner. Although the Joint Stock Company Law provisions relating to takeovers cover actions of the buyer acting with its affiliated persons rather than shareholders acting in concert, the affiliated persons include a rather wide spectrum including individuals, and the affiliated person's lists are obligatory for disclosure, thus ensuring that this provision of the law is really working in practice. CBR takes into account the recommendation on this principle and is working on corresponding amendments to the legislation.

Principle 22

88. The following should be noted in assigning a grade to Principle 22 ("Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision"). With the aim of applying the newly adopted CRA Law, the CBR has issued Regulation № 521-P dated January 17, 2015 "On the Procedure of CBR Maintaining CRAs Register, Foreign CRAs' Branches and Offices, on the Requirements for Procedure and Form of CRAs Notifications Submission." In accordance with the new Regulation, business companies can apply to be registered as credit rating agencies. Furthermore, on February 29, 2016, one business company has already applied to be registered under Regulation No 521-P as a credit rating agency (CRA).

89. Furthermore, regarding the requirements on the relevance of work experience, Section 4 of Article 7 of Federal Law 222-FZ lays down requirements for the relevance of work experience in position as a senior manager at a CRA or its structural units or any analytical agency or research center, or a financial organization or its structural unit operating in the financial market, or have experience of work with CBR or a federal executive body acting as a regulator of the financial market in a position not lower than a structural unit head for at least one year in case of higher education degree in Economics, Law, Mathematics (technical), and at least two years in the event of a different higher education degree.

Principle 29

90. In reference to the assessors' comment regarding the absence of a regulation on investment advisors, it is important to mention that the draft law amending the Securities Law on investment advisors' activity was already submitted to the State Duma. Provisions of the new law establish a financial consulting implementation framework, including the requirements for investment advisors and self-regulatory organizations of investment advisors, and govern interactions between the investment advisor and clients. They also set out requirements on clients' investment profiles, and determine the rights and duties of a financial advisor.

Principle 31

91. Principle 31 ("Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters") was downgraded from "partly implemented" to "not implemented" owing to findings of a lack of regulation in the following respects.

Conflicts of interest

92. CBR Regulation № 3234 contains specific requirements on brokers to control the risks inherent in direct (or indirect) client access to the exchange; and there is a mandatory system of pre-order validation for every client which allows a broker to set limits to prevent a client from placing orders exceeding those limits. This comment is in response to the statement that there are no provisions relating to the controls necessary to prevent a client with direct access to an exchange from placing an order that exceeds specified limits.

Internal controls

93. According to passage 1.1 of Article 10 of the Securities Law, professional intermediaries operating in the securities market have to organize and exercise compliance and internal audit. In order to organize and exercise compliance, professional intermediaries operating in the securities market are obliged to appoint a compliance officer or to form a separate division within their organization (compliance service).

94. Professional intermediaries operating in the securities market are required to organize a RM system with respect to their professional activity in the securities market and operations with own funds. The RM system has to be commensurate with the nature of the operations of the professional intermediary operating in the securities market and include a risk monitoring system that provides timely information to the Board.

95. Requirements aimed at regulation of compliance, internal audit, and the organization of RM systems of professional intermediaries operating in the securities market are currently under development.

Protection of clients' rights

96. The Article 3 of the Securities Law imposes obligations on brokerage firms to act with due care and diligence in the interests of a client and to place the interests of the client above their own.

DETAILED ASSESSMENT

97. **The purpose of the assessment is primarily to ascertain whether the legal and regulatory securities markets requirements of the country and the operations of the securities regulatory authorities in implementing and enforcing these requirements in practice meet the standards set out in the IOSCO Principles.** The assessment is to be a means of identifying potential gaps, inconsistencies, weaknesses and areas where further powers and/or better implementation of the existing framework may be necessary and used as a basis for establishing priorities for improvements to the current regulatory scheme.

98. **The assessment of the country's observance of each individual principle is made by assigning to it one of the following assessment categories: fully implemented, broadly implemented, partly implemented, not implemented, and not applicable.** The IOSCO assessment methodology provides a set of assessment criteria to be met in respect of each principle to achieve the designated benchmarks. The methodology recognizes that the means of implementation may vary depending on the domestic context, structure, and stage of development of the country's capital market and acknowledges that regulatory authorities may implement the principles in many different ways.

Table 8. Detailed Assessment of Implementation of the IOSCO Principles

Principles for the Regulator	
Principle 1	The responsibilities of the Regulator should be clear and objectively stated.
Description	<p>In September 2013 a process was begun by Presidential decree in which the powers and functions of the Federal Service for Financial Markets (FSFM) were transferred to CBR. This was a three stage process that was completed in the course of 2015. Most of the 1,300 employees of the FSFM became employees of the central bank. The FSFM had been tasked with regulating financial markets, supervising exchanges, and overseeing credit and commodity markets. The FSFM was also responsible for pension funds as well as ensuring legislative compliance regarding insider trading and market manipulation. CBR is referred to colloquially as the “mega” regulator. The law which achieved the transfer is Federal Law No. 251-FZ of 7/23/2013 <i>On Amendments to Certain Russian Federation Legislative Acts in Connection with the Transfer to the Russian Federation Central Bank of Powers of Regulation, Oversight and Supervision in the Area of Financial Markets.</i></p> <p>CBR’s responsibilities, powers, and authority are set out in a large number of legislative acts that in most cases have been amended repeatedly since first being passed by the Duma. These include:</p> <ul style="list-style-type: none"> • Federal Law No. 39-FZ of April 22, 1996, On the Securities Market; • Federal Law No. 86-FZ of July 10, 2002, On the Russian Federation Central Bank (CBR); • Federal Law No. 208-FZ of December 26, 1995, On Joint Stock Companies; • Federal Law No. 75-FZ of May 7, 1998, On Nongovernmental Pension Funds; • Federal Law No. 156-FZ of November 29, 2001, On Investment Funds; • Federal Law No. 46-FZ of March 5, 1999, On Protection of the Rights and Legitimate Interests of Investors in the Securities Market; • Federal Law No. 224-FZ of July 27, 2010, On Combating the Wrongful Use of Insider Information and Market Manipulation; • Federal Law No. 325-FZ of November 21, 2011, On Organized Trading; • Federal Law No. 7-FZ of February 7, 2011, On Clearing and Clearing Activity; and • Federal Law No. 414-FZ of December 7, 2011, On the Central Depository. <p>Generally, each law includes provisions that set out the powers of CBR. For example, Article 51.6 of the Securities Market Law states:</p> <p>Professional activity in the securities market carried out without a license shall be illegal. In respect of the persons who carry out their activity without licenses CBR shall:</p> <ul style="list-style-type: none"> • adopt measures to stop the unlicensed activity;

- insert data on the official Internet site thereof of the facts of license-free activities of a securities market participant;
- inform in writing the persons concerned about the need to obtain a license, and also fix the time for this;
- send the materials of inspection of the facts of the unlicensed activity to a court of law for the enforcement of measures of administrative responsibility against the officials of the brokerage company;
- file a claim with a court of arbitration on the recovery for the benefit of the state of incomes received as a result of unlicensed activity in the stock market; and
- file a claim with a court of arbitration on the forcible liquidation of the brokerage company if it has failed to obtain a license within the fixed period of time.

As for licensed persons, Article 44(4), for example, states that, if a professional participant within one year repeatedly violate the securities legislation of the Russian Federation and/or court enforcement action, CBR shall take a decision to suspend or annul its securities market license. For single offenses the law requires that other administrative measures must be used first.

The Central Bank Act (Article 3) sets out the purposes of CBR as follows (relevant excerpts):

- To develop the financial market of the Russian Federation; and
- to ensure stability of the financial market of the Russian Federation.

The Central Bank Act (Article 4) sets out the functions that CBR shall fulfil (relevant excerpts): it shall elaborate and pursue in collaboration with the Government of the Russian Federation the policy of developing and ensuring the stable functioning of the financial market of the Russian Federation and:

- it shall set the rules to effect settlements in the Russian Federation;
- it shall exercise supervision over the activities of credit institutions and banking groups;
- it shall exercise regulation, control and supervision over the activities of non-credit financial institutions in compliance with federal laws;
- it shall register equity securities issues, securities prospectuses and reports on the results of the issuance of equity securities;
- it shall exercise control and supervision over the observance by issuers of the requirements of Russian Federation legislation on joint-stock companies and securities;
- it shall exercise regulation, control and supervision in the area of corporate relations in joint-stock companies;

- it shall approve sectoral accounting standards for credit institutions, CBR and non-credit financial institutions;
- it shall exercise control over the observance of the requirements of Russian Federation legislation on countering the illegal use of insider information and market manipulation;
- it shall protect the rights and legitimate interests of shareholders and investors on financial markets.

In fulfilling its functions stipulated by federal laws, CBR is obliged to elaborate and pursue a policy for preventing, detecting and managing conflicts of interests.

To carry out its functions as set out in Article 7 of the Central Bank Law, CBR issues legal acts in the form of regulations, instructions and directions on issues within its responsibilities. Compliance with such acts is obligatory for all federal governing bodies, governing bodies of the constituent entities of the Russian Federation and local authorities, and all legal and physical persons. The rules for drafting such normative acts are set by CBR independently.

All regulations, instructions and directions that concern or regulate third parties' rights are subject to registration by the MoJ. Such regulations, instructions and directions have equal legal force. The main difference is their internal structure. According to Regulation No. 519 dated September 15, 1997 *"On the order of drafting and entrance into force of CBR legal acts"* approved by the Order of CBR No. 02-395 dated September 15, 1997:

- An act should be adopted in the form of a direction if it sets out separate rules on matters related to CBR competence.
- An act should be adopted in the form of a regulation if it sets systemically connected rules on matters related to CBR competence.
- An act should be adopted in the form of an instruction if it sets rules of application of norms of federal laws and other legal acts on matters related to CBR competence.

Amendments to all these three types of legal instruments are adopted in the form of direction.

In addition, the Bank issues internal acts that regulate the actions of its employees (departments, sub-divisions) and obligatory only for its employees. Such acts may also be adopted in the form of regulations, instructions and directions.

Finally, CBR can issue non-regulatory instruments that regulate internal organizational and administrative issues. According to Instruction of CBR No. 159-I dated December 24, 2014 *"On document support of management in the central office of CBR"* such acts may be issued in the form of orders, information letters, methodological clarifications, decrees and others.

As discussed in Market Structure, Section D "Preconditions," there is a hierarchy of laws in Russia confirmed by the Constitutional Court. The general principles are that general laws (such

	<p>as the Securities Market Law) are over-riden by special laws, such as the Insider Trading and Market Manipulation Law where they overlap or conflict; and newer laws override older laws.</p> <p>CBR's powers to interpret its authority are constrained by the federal laws it enforces. These are not subject to expansion or modification except by further amendment to the laws.</p> <p>In addition, CBR considers that its ability to interpret its authority is further constrained as a result of the enhanced transparency under which it operates as a result of the public consultation it engages in on new and amended regulatory matters in which it explains the purpose behind each regulatory initiative. Also, CBR has no power to exempt legal or natural persons from a law's provisions.</p> <p>Since regulation of securities market and their participants is carried out solely by CBR, no issues arise with respect to regulatory differences and gaps arising from multiple regulators. CBR does however operate under multiple laws and so must work to address matters of regulatory arbitrage and issues that arise from its obligation to regulate multi-functional groups on a consolidated basis. The Committees of Banking and Securities Supervision consisting of department heads, meets twice weekly to develop a unified approach. Where necessary they set up working groups to examine matters more closely. Recent initiatives have included securitization and internal audit.</p> <p>Under Central Bank Law, Article 21, to fulfil its functions CBR participates in developing the economic policy of the Russian Federation Government. The CBR Chairman or one of his deputies takes part in meetings with the Russian Federation Government and may also participate in State Duma sessions discussing draft laws on issues relating to economic, financial, credit, and banking policies. In addition, the CBR cooperates with state authorities and local governments in cases prescribed by law.</p> <p>For example, the Board of Directors of the CBR in cooperation with the Government of the Russian Federation is required to develop draft guidelines for the development of the financial markets and submit them for consideration to the National Finance Council, the President of the Russian Federation, the Government of the Russian Federation, and the State Duma (Central Bank Law Article 18). Within the framework of cooperation with the ministries, departments of the CBR are developing guidelines, regulations and agreements on inter-agency cooperation.</p>
Assessment	Broadly Implemented
Comments	<p>Although at the level of the federal Laws the powers and authority of the CBR are set out comprehensively and with reasonable clarity, the evolution of the regulatory framework whereby the federal laws have been repeatedly revised while at the same time the FSFM and, more recently, the CBR, have issued numerous directions, regulations, and instructions, has led to the creation of overlapping legal obligations, often with differences which would be minor if not for the legally binding nature of all such obligations. Many FSFM acts are still in force. In some cases, variations result in one group of market participants being subject to obligations</p>

	<p>to which other are not, for no obvious reason. See for example the description section of Principle 9 on SROs and differentiated disclosure obligations identified in Principle 11.</p> <p>It must be doubted that even with substantial and highly skilled compliance departments, most licensed firms (or their SROs) are able to stay fully compliant on a consistent basis. Investors too face substantial difficulties in understanding what their rights are in their relationship with market participants or through ownership of a particular financial product.</p> <p>The draft <i>Guidelines for the Development and Stability of the Financial Market of the Russian Federation for the Period of 2016–18</i> has, as one of its goals “creating conditions for the growth of the financial industry.” It has identified as critical to the achievement of that goal “enhancing financial market regulation, inter alia through proportional regulation and optimization of the regulatory burden on financial market participants.” It would be consistent with that goal for the CBR, perhaps in conjunction with the MoF and industry representatives, to set up a program with the objective of achieving a substantial simplification of the regulatory framework while retaining and, enhancing those elements of regulation, supervision and enforcement which are necessary to achieve the other goals set out in the draft guidelines, namely “improving the living standards for the Russian population through the use of financial market instruments”; and “facilitating economic growth through granting the competitive access of Russian economic agents to debt and equity financing.”</p>
Principle 2	The Regulator should be operationally independent and accountable in the exercise of its functions and powers
Description	<p>Independence</p> <p>The political independence of the CBR is set out in the Central Bank Law. Article 1 states that the status, purposes, functions and powers of the CBR are stipulated by the Constitution of the Russian Federation, this federal law and other federal laws. It goes on to state that the CBR shall fulfill the functions and exercise the powers stipulated by the Constitution of the Russian Federation and this federal law independently from other federal bodies of state power, the bodies of state power of the constituent entities of the Russian Federation and local self-government bodies.</p> <p>Article 2 states that the authorized capital and other property of the CBR shall be in federal ownership. In pursuance of its purposes and in accordance with the procedure established by this federal law, the CBR shall exercise its powers to own, use, and manage its property, including the gold and currency (international) reserves of the CBR. This property may not be confiscated or encumbered with obligations without CBR consent unless the federal law stipulates otherwise. The state shall not be liable for the obligations of the CBR and the CBR shall not be liable for the obligations of the state unless they have assumed such obligations or unless federal laws stipulate otherwise. The CBR shall cover its expenses with its own revenues.</p>

Governance

The Board of Directors is comprised of the CBR Chairman (Governor) and 14 Board members (first deputy governors and deputy governors) all of whom work in the CBR on a full-time basis.

In addition, Article 21 of the Central Bank Law states that the Minister of Finance of the Russian Federation and the Minister of Economic Development of the Russian Federation or their representatives shall participate in the Board of Directors' meetings with the right of a "consultative vote." Decisions are taken by a majority of the Board of Directors. The consultative votes of the ministers are not counted but their views are recorded in the minutes.

Article 19 states that members of the Board of Directors cannot be deputies of the State Duma, members of the Federation Council, deputies of the legislative (representative) bodies of the constituent entities of the Russian Federation, deputies of the bodies of local self-government, civil servants or members of the Russian Federation Government.

A member of the Board of Directors cannot be a member of any political party or hold any position in a public, political, or religious organization.

The functions of the Board of Directors are set out in Article 18 of the Central Bank Law and cannot be extended. The functions are extensive and cover typical central bank issues such as monetary policy and also matters concerning the annual financial statement of the CBR and certain budgetary matter for which approval is required from the National Financial Board (NFB). It also has a specific responsibility for deciding whether or not a request for confidential information from a foreign regulatory body should be provided, or whether the request should be declined on grounds that the information requested constitutes a state secret (Article 51.1 of the Central Bank Law).

It also works with the Government of the Russian federation in drafting guidelines for the development of the financial markets and to ensure their implementation.

It also approves compulsory standards for credit institutions and banking groups, and also for non-credit financial institutions and approves sectoral accounting standards for credit institutions and non-credit financial organizations.

The Board does not have a direct role in approving specific supervisory decisions in financial markets such as the approval of new products nor any role in supervision such as the granting or revocation of licenses, the imposition of administrative sanctions or the referral of criminal offenses to the investigating authorities. All these functions of the CBR are reserved for the executive where the senior decision making bodies are the Committees on Banking and Securities Market Supervision.

There are mechanisms that seek to ensure that commercial interests cannot influence the operational activities of the CBR. A member of the Board of Directors is subject to the

restrictions imposed by Article 90 of the Central Bank Law which says (in part): CBR employees holding positions included in a list approved by the Board of Directors shall not be allowed:

- to hold more than one job or work under a contract agreement (except for teaching, research, and creative work);
- to hold jobs in credit and other institutions; and
- to acquire securities, shares (stakes in the authorized capital of organizations), which may yield income, in cases when this may result in a conflict of interest, except for cases established by federal law.

Furthermore, under Article 8 the CBR is prevented from taking commercial interests in credit institutions or other commercial or non-commercial organizations unless the law specifically permits. An exception applies to holdings by the CBR of the capital of the Savings Bank of the Russian Federation (Sberbank). The same prohibition applies in the cases of other commercial and non-commercial organizations unless they are providing support to the activities of the CBR and its institutions, organization, and employees.

Consultation with the Government of the Russian Federation is established in Article 21 of the Central Bank Law whereby the parties shall inform each other on matters of national importance, coordinate their policies, and hold regular joint consultations.

Funding

In terms of funding its operations, the CBR covers its expenses from its own revenues as required by Article 2 of the Central Bank Law. According to the 2014 annual report, in that year the CBR had income of RUB 590,860 million, expenses of RUB 407,532 million, and a profit of RUB 183,508 million. The profit was up from RUB 129,261 million in 2013. 90 percent of the profit goes to the state budget but the rest remains in reserves. Under the Law, that percentage can be changed by the government as it so wishes.

Legal protection

There are no special protections from legal liability for the Board or staff of the CBR in relation to an act done or omitted in good faith in performance of any function, or in exercise or purported exercise of any power. In practice the CBR believes that an action against individual staff members are unlikely as decisions are taken on a collegial basis.

Article 5 of the Central Bank Law states that the CBR shall be accountable to the State Duma of the Federal Assembly of the Russian Federation. The powers of the State Duma include the power to appoint and dismiss the CBR Chairman at the proposal of the Russian Federation President. It is also empowered to appoint and dismiss members of the CBR Board of Directors at the proposal of the CBR Chairman with the agreement of the Russian Federation President.

However, Article 14 states that the chairman shall be appointed by the State Duma for a term of five years by a majority of votes of the total number of State Duma deputies.

The chairman may only be dismissed in the following cases:

- when his term expires (no person may hold the post of chairman for more than three consecutive terms);
- if he is unable to fulfill his duties for health reasons confirmed by a government medical commission;
- if he submits a letter of resignation;
- if he has committed an indictable crime established by a court ruling that has come into force;
- if he has violated any federal law regulating the activities of the CBR; and
- if he violated any terms of the Federal Law No. 273-FZ of December 25, 2008, "On Countering Corruption" and the Federal Law "On Control Over Conformity Between Expenses of Government Officials and Other Persons, and their Income."

Under Article 15 of the Central Bank Law the Directors can be dismissed by the State Duma:

- upon the expiry of their five-year term;
- at the proposal of the CBR Chairman before the expiry of their term; and
- at the proposal of the CBR Chairman in the event of a failure to take measures in compliance with the last bullet above.

Accountability

Accountability of the CBR is through the State Duma under Article 5 of the Central Bank Law. The State Duma:

- considers annual reports of the CBR and adopts decisions on them;
- takes a decision on an inspection by the Audit Chamber of the Russian Federation of the financial and economic activities of the CBR and its units and divisions. Such a decision may only be taken on the basis of a proposal of the National Financial Council; and
- conducts parliamentary hearings on the activities of the CBR with the participation of its representatives.

The CBR must provide information to the State Duma and the Russian Federation President in accordance with the procedure established by federal laws. The amount of information disclosed to the State Duma depends on the circumstances and the nature of the information.

There are some restrictions on disclosures and these apply to disclosures to the State Duma as well.

The published annual report and financial statements set out in detail the operations of the CBR in the course of the reporting year and its use of resources. The 2014 statements were audited by PWC and Financial and Accounting Consultants LLC. Data covered by the law on state secrets was assessed by the Audit Chamber of the Russian Federation and its opinion passed to the auditors as noted in their report.

Sanctions, appeals, and disclosure

The CBR publishes its decisions to impose administrative sanctions in certain cases, notably those involving insider dealing or market manipulation as required under Article 15 of the Federal Law of July 27, 2010 No. 224-FZ "On combating unauthorized use of insider information and market manipulation."

Numerous provisions of the laws require the CBR to give written reasons for its material decisions.

In matters arising from the issue of and trading in equity securities, the CBR is required to provide within 30 days reasoned replies to requests from legal and natural persons on matters within the competence of the CBR (Article 44.1. of the Securities Market Law).

Having made a decision to revoke the license for professional activity in the securities market the CBR is obliged to specify the grounds for its annulment (Article 39.1 of the Securities Market Law).

Decision-making regarding sanctioning is a group responsibility within the CBR, which limits the possibility of abuse of process. Under the law a license can be revoked for repeated violations (see Principle 1) and only after other less severe administrative sanctions have been applied. The CBR has an internal appeals procedure for administrative sanctions short of license revocation, although it appears to be rarely used. An appeal is heard by a deputy governor from a different department from the one seeking to impose the sanction. A decision to revoke a license can be appealed only to the court. The court could tell the CBR to reconsider and explain why the decision to refuse may be illegal but it has never happened.

Legal or natural persons who believe they will be adversely affected by a decision of the CBR in the exercise of its administrative authority may present their position prior to the CBR taking a decision. See for example CBR Instruction No. 156-I of September 1, 2014, "On Organization of the Inspection Activities of the Russian Federation Central Bank (CBR) With Respect to Non-Lending Financial Institutions and Self-Regulatory Organizations of Non-Lending Financial Institutions."

	<p>In the case of a fine, the party has 10 days to appeal and is not required to pay until the appeals process is exhausted. For a license revocation, the decision is enforced from the day the decision is taken.</p> <p>Examples</p> <p>Under Article 60.1, Clause 16, Federal Law No. 156-FZ of November 29, 2001, On Investment Funds, an applicant for a license is entitled to appeal against the refusal of the CBR to grant the license or its omission to act.</p> <p>Under Article 26.13 of Federal Law No. 325-FZ of November 21, 2011, "On Organized Trading" an applicant for a license to operate a trading system may appeal, against a refusal of CBR to issue the license or its failure to make a decision.</p> <p>Under the Securities Market Law No. 39-FZ Article 21 a decision on the refusal to register the issue of securities and the issue of a prospectus may be appealed against in a court of law or a court of arbitration.</p> <p>Under Securities Market Law Article 51.8 a professional stock market participant or an issuer of securities has the right to appeal to an arbitration court over the actions of CBR aimed at stopping breaches of the legislation of the Russian Federation.</p> <p>Under Securities Market Law Article 51.8 natural persons whose qualification certificates concerning professional activities in the securities market have been withdrawn have the right to appeal against the decision of CBR to an arbitration court.</p>
Assessment	Partly Implemented
Comments	<p>The reasons for the rating arises the lack of legal protection for staff when performing regulatory functions such as carrying out investigations into possible breaches of the law and normative acts of CBR made under the law. It is generally accepted that reckless or negligent behavior should not be immune from civil action by the party or parties affected, although even here the expectation is that the employer regulator will finance a defense if it believes the allegation has little or no merit. Immunity is however considered essential for effective performance of regulatory responsibilities where decisions have been made on the basis of due diligence and in good faith.</p> <p>The right of the Ministers of Finance and Economic Development to attend Board meetings with a right to participate in discussions and express opinions to be recorded in the minutes is a matter of some concern. Although the functions of the Board exclude direct involvement in supervisory decisions, the Board is ultimately responsible for all actions by CBR. This direct political influence on matters decided at the Board is difficult to reconcile with the IOSCO requirement that the regulator should be able to operate on a day-to-day basis without</p>

	external political interference and can also be criticized for lack of transparency in the relationship between the Ministries and the Board as the meeting minutes are not published.
Principle 3	The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	<p>CBR's powers, as set out in the laws listed in Principle 1, which include licensing, supervision, inspection, enforcement, and sanctioning of all professional market participants, and the drafting of associated regulations are sufficient for the implementation of its responsibilities. Although professional market participants pay fees for licensing and other requirements, these fees are set in the tax code and cannot be amended by CBR. In any case these fees go directly to the state budget and not to CBR. CBR's income is derived from other central bank sources such as interest income and trading in securities, foreign exchange, and gold.</p> <p>The retained profit of CBR appears sufficient to enable CBR to meet its responsibilities as a securities market regulator as well as its responsibilities as a central bank and supervisor of banks, insurance companies, and non-state pension funds.</p> <p>The budget process works on the basis of a bottom up approach with the preparation of departmental budget estimates and request for funding that are ultimately considered by CBR's internal budget commission that prepares a draft budget for consideration and approval by the Board. The budget is then referred to the NFB, the approval of which is necessary for the following items:</p> <ul style="list-style-type: none"> • Staff salaries; • Life insurance and medical insurance for staff; • Administrative expenses; and • Capital expenses. <p>The NFB is a "collegiate body of CBR" (Article 12, Central Bank Law) but has a broader membership. Its twelve members are the governor; two from the upper chamber (Federation Council), three from the lower chamber (State Duma), three from government and three from the president's administration. The chairman is appointed by majority vote of the council members and other decisions follow the same practice (with a quorum of seven).</p> <p>CBR cannot exceed the amount for staff and the other three areas for which NFB approval is required. Otherwise it can alter the expenditure within the limits set by the NFB. During the last 12 years, the NFB has never revised the budget, as CBR pays its expenses out of its own revenues. This is despite recent difficulties in the Federal budget. The departments of CBR responsible for financial market supervision receive equitable treatment in the allocation of funds.</p>

	<p>Staffing</p> <p>CBR is viewed as an attractive employer as regards pay and social status. Staff turnover is low, at 5 percent. The introduction in 2014 of changes to the work pay and incentive system for staff and the transition to a new bonus policy, based mainly on assessment of employees' own work and that of CBR divisions, was part of a process to enhance the bank's ability to assess the performance of its employees. The performance assessment results are considered not only when determining the size of employee bonuses but also when transferring employees to other positions, and sending them to training courses. The focus is on effectively motivating younger staff members.</p> <p>An important area of Human Resources policy is training, retraining and professional development of executives and experts. In 2014, 4,300 training events were held in the framework of the corporate system for the additional professional training of CBR personnel. This includes 33,880 employees who have completed the training, as well as 92 training events for 1,825 executives and experts working in the supervision function, of which 51 employees completed professional retraining programs of over 500 academic hours. 104 CBR employees completed the FSI Connect online learning program developed by the Financial Stability Institute of the Bank for International Settlements for experts working as supervisors in the financial sector. Since the program was launched in 2012, 437 employees have undergone this training.</p> <p>Governance practices</p> <p>CBR structure includes the central office, 81 regional branches, as well as seven main branches with 72 divisions and two divisions—in Crimea and Sebastopol. This is a new structure created over the past two years. Regional units coordinate their activities with headquarters. If a systemic issue arises, the issue is presented to senior management.</p> <p>The headquarters has 39 structural units responsible for different areas of activity. The organization is divided into what are termed structural units (which may be departments, services or divisions but some with other names such as inspections). The central structural units are in charge of policy. Implementation is the responsibility of the territorial units. The central structural units oversee the work of the territorial units. The preparation of material on decision-making is the responsibility of the territorial unit. The broader implications of such decisions are covered by consultation with central structural units. This is especially so when a local securities firm is part of a national group.</p> <p>There is an Internal Audit Department of 100–120 people. This is headed by a controller who reports to the chief auditor who reports directly to the governor. The Legal Department also reports to the governor.</p> <p>There is much work on the development of new regulations. In February 2016 there were at least 18 work streams focused on regulatory and legislative amendments intended to enhance</p>
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	<p>the effectiveness of CBR's supervisor of financial markets and professional market participants. The cost of regulation is a critical factor in decision-making.</p> <p>As described in Principle 1, CBR's powers to interpret its authority are constrained by the federal laws it enforces. The drafting of regulations, directions, etc. is governed by Regulation No. 519 dated September 15, 1997 "On the order of drafting and entrance into force of CBR legal acts." This is a public domain regulation and so the process is transparent. The regulation requires that a structural unit that is interested in preparing a draft act will consult other structural units. If a consensus is reached it is placed on CBR website for public discussion. Once any comments have been considered it is put to the Committees on Banking and Securities Market Supervision and then to the governor for signature. The act is then sent to the MoJ for registration. The final form act is then published on CBR website and comes into force ten days later. CBR can vary the timings the timing of the entry into force of different provisions within it.</p> <p>Investor education</p> <p>Financial literacy is a main focus of CBR and a priority for the next three years. In the draft <i>Guidelines for the Development and Stability of the Financial Market of the Russian Federation for the Period of 2016–18</i> a Key Goal is improving the living standards of the Russian population through the use of financial market instruments. The area of development identified as being critical in realizing this goal is ensuring financial services consumers' protection and financial inclusion, and raising the level of financial literacy among the Russian population. Measures identified and being taken forward to raise the standard of financial literacy include:</p> <ul style="list-style-type: none"> • Introduction of obligatory financial literacy classes in general education institutes; • Creation of a specialized CBR webpage devote to numerous issues in the field of financial literacy in an easily understandable way; • Defining optimal financial literacy promotion channels for different household groups and the most suitable financial products considering individual characteristics as well as consumer expectations; and • Creation of financial literacy level evaluation toolkit.
Assessment	Broadly Implemented
Comments	<p>Although CBR has control of its operational budget once that has been agreed, the overall size of the budget is established by a decision of the NFB of which CBR member (the governor) has one vote among 12. Since staff salaries and administrative expenses constitute the major part of the banks expenses, there is potential for the Presidential administration, federal government, and the legislature to exercise definitive influence over the resources the bank has for regulation and supervision.</p>

	<p>Within the constraints imposed by the complexity of the legal and regulatory system, and as described verbally, CBR appears to have policies and governance practices to perform its functions and exercise its powers effectively.</p> <p>The work of CBR in the field of investor education is well regarded by an independent body which itself sponsors financial literacy initiatives and defends consumer rights.</p>
Principle 4	The regulator should adopt clear and consistent regulatory processes.
Description	<p>CBR is subject to the Constitution of the Russian Federation (Article 75), the Central Bank Law and other legislative acts of the Russian Federation such as the Administrative Code, which covers enforcement matters, and Article 172.1 of the Criminal Code of the Russian Federation with regard to the falsifying financial documents such as accounts and statements of financial position. Under Article 761 of the Central Bank Law CBR cannot interfere in the operational activities of non-credit financial institutions, except for the cases stipulated by federal laws, which are strictly defined. Compliance with its legal obligations requires CBR to operate under reasonable rules and regulations. As noted in Principle 1, its powers to act on a discretionary basis are very limited.</p> <p>Within the constraints imposed by the complexity of the legal and regulatory system CBR seeks to ensure that its policies and procedures are predictable, comprehensible, and transparent. In CBR's view, this objective is served by development of CBR's first document on development of the financial market, Basic Guidelines for the Development and Operational Stability of the Russian Federation Financial Market in 2016–18. That document specifies strategic guidelines for the development and operational stability of the financial market of the Russian Federation at the cross-sectional level—for all sectors of the financial market. CBR's development of this document once every three years is required by the Central Bank Law and involves extensive discussions with the main stakeholders to establish the priority medium-term objectives including optimization of the regulatory burden on participants in the financial market and the use of proportional regulation, including the development of a selective approach to the regulation and surveillance of financial institutions depending on the sector's level of development and taking into account its specific features and financial operations and risks.</p> <p>Public consultation</p> <p>CBR places on its website for public inspection, drafts of newsletters, directives, orders, and other documents containing approaches to the regulation of the securities market, including the key issues of interpretation, changes and reasons for changes in rules or policies. In addition, the above documents are published in an official publication of the Bank—"Bulletin of CBR." It also sets up working groups involving representatives of the business community for public discussion of the draft provisions, etc. Although the powers of CBR to interpret the law are limited, it also publishes commentaries on how it has acted previously in response to certain defined situations or events.</p>

Regulatory costs

An example of public consultation is the approach adopted by CBR with regard to the cost of compliance. In accordance with the order of CBR of December 27, 2014 No. ML-3716 "On the order of the regulatory impact assessment of draft normative acts of CBR." CBR regulations are evaluated for the presence or absence of provisions introducing excessive duties, prohibitions and restrictions, entailing unreasonable costs for the persons who would be subject to the regulation. Regulatory Impact Assessment includes the following steps: placing the draft for public discussion on the official website of CBR; analysis and evaluation of the proposals and comments on the project; and adoption of conclusions.

Procedural fairness

As part of its activities CBR employs principles of legality and fairness, allowing supervised institutions in case of minor violations to eliminate the violations without major sanctions (for example, minor delays in the filing of required documentation).

As described in Principle 2, decision making regards sanctioning is a group responsibility within CBR. Legal or natural persons who believe they will be adversely affected by a decision of CBR in the exercise of its administrative authority, may present their position prior to CBR taking a decision. Under the law a license can be revoked for repeated violations (see Principle 1) and only after other less severe administrative sanctions have been applied. CBR has an internal appeals procedure for administrative sanctions short of license revocation, although it appears to be rarely used. An appeal is heard by a deputy governor from a different department from the one seeking to impose the sanction. A decision to revoke a license can be appealed only to the court. The court could tell CBR to reconsider with an explanation as to why the decision to refuse may be illegal but it has never happened.

CBR is required to give written reasons for its decisions. As described in Principle 2, under the Central Bank Law (Article 7), all CBR normative acts may be appealed against in court in accordance with established procedures.

The general criteria for granting, denying, or revoking a license are found in:

- Instruction of CBR from September 13, 2015 No. 168 "On the procedure for licensing by CBR of professional activity in the securities market and the order of keeping the register of professional participants of the securities market";
- Instruction of CBR from June 29, 2015 No. 166 "On the procedure for licensing joint-stock investment funds, management companies and specialized depositaries, the order of keeping the register of licenses of joint-stock investment funds, management companies register of licenses and register of licenses specialized depositaries, the procedure for notifying CBR to change Information on officials of joint-stock investment fund MC and a specialized depositary."

	<p>These instructions are published in the "Bulletin of CBR" as well as being posted on the official website of CBR.</p> <p>Reports on investigations are not made public while an investigation is ongoing but may be made public once a decision has been made to impose administrative sanctions. CBR has a policy of disclosing decisions made on cases involving insider dealing and market manipulation on its website shortly after a case has been concluded.</p> <p>In addition to the procedural processes set out above, in order to secure the uniform application of laws by which CBR supervises non-credit financial institutions CBR developed regulations governing the sequence of actions during inspections. These include the CBR Instruction of April 24, 2014 No. 151 "On the procedure of inspections of non-credit financial institutions and self-regulatory organizations of non-credit financial institutions by authorized representatives of the CBR" and CBR instruction of September 1, 2014 No. 156-I "On the organization of the inspection activities of the CBR, in respect of non-credit financial institutions and self-regulatory organizations of non-credit financial institutions."</p> <p>Within CBR, consistency of decision making is achieved via the Financial Supervision Committee that considers cases. This is chaired by a first deputy governor and membership includes a deputy governor, heads and deputy heads of structural units. Decision making is by majority. Cases decided by the territorial units are also considered to ensure consistency. The individual decision makers explain the reasons for the decision. Such reviews of decisions are then circulated so that all can learn from them. Internal Audit provides a further check.</p>
Assessment	Fully Implemented
Comments	<p>Among industry participants there was a mix of opinions on the commitment of CBR to "real" consultation. There was a clear majority of the view that CBR is serious in seeking views of market participants and the public and that engaging with CBR by responding to public consultations or participation in CBR workshops is worthwhile and can secure improvements in proposed regulatory approaches. Similarly, while industry participants did not criticize CBR for exercising its powers inconsistently, there were a few comments on the rigor of its supervisory approach compared to its predecessor. CBR will need to ensure that it continues to enjoy support for its consultation process if it is to secure willing rather than grudging support for its development of more effective regulation, particularly among the nonbank licensees for whom the more intrusive central bank style of regulation has caused some unease.</p>
Principle 5	The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality.
Description	<p>Requirements for employees of CBR are, to a large extent, set out in Chapter 14 of the Central Bank Law.</p> <p>Article 90(3) of the Central Bank Law, sets out the prohibition on buying securities. This is imposed on "employees holding positions included in a list approved by the Board of</p>

Directors;" those securities are "ones which may yield income" or where purchase "may result in a conflict of interests," and does not apply to "cases established by federal laws." There are no specific constraints on an employee's close family members dealing when the employee may not, although Article 11.1 of the Federal Law of December 25, 2008 No. 273-FZ "On Corruption Counteraction" sets out the basic principle according to which CBR employees must eliminate any possibility of the conflict of interest and notify their superiors immediately of any personal interest in their service duties which includes the possible obtaining the benefits by the employee's close family members (Article 10, item 2). See below. Staff are also subject to the Insider Dealing Law (see Principle 36) and CBR has issued Ordinance of October 31, 2011 No. 2723-U "On Insider Information of CBR." This Ordinance stated the list of such information.

The requirements to prevent conflicts of interest, are contained in Article 90, the restrictions on ownership of securities in paragraph 8 of Article 90; the requirements on disclosure of financial position (information about income, expenses, assets, and liabilities as regards real property) in Article 90.1.

In-house conflicts of interest

CBR is an active trader on several MOEX markets: for ex, repo and government and corporate bond trading as is Sberbank, in which CBR owes 51 percent. In accordance with Article 51.6 of the Central Bank Law, in order to prevent, identify, and manage conflicts of interest when exercising functions under federal laws, CBR's responsibilities in respect of decision making on monetary policy, supervision and regulation on the financial market are assigned to different deputy governors of CBR. CBR believes that this organizational structure avoids in-house conflicts of interests.

A number of measures were taken in 2014 in order to eliminate CBR and Sberbank influence on the decisions of MOEX. Before 2014 CBR owned 22.47 percent of the Exchange's shares, and Sberbank owned 9.9 percent. Thus, before 2014 CBR in affiliation with PJSC Sberbank owned a blocking shareholding of the Exchange. This allowed them to block crucial decisions of the shareholders' General Meeting of the Exchange and to exercise the right to include relevant number of members to the Exchange's Supervisory Board. In 2014 the stake of CBR in the Exchange was cut from 22.47 percent to 11.73 percent. Thus, CBR no longer owns a blocking shareholding of the Exchange either individually or jointly with Sberbank.

Special measures were also taken to reduce of the number of CBR's representatives on the Exchange's Supervisory Board. Currently only 2 of 15 members of the Supervisory Board) are CBR representatives. One is the Chief Auditor of the CBR whose independence within CBR is established by the CBR Regulation of June 4, 2012 No 376-P "On Internal Audit at the Central Bank. The other representative is the Dean of Free Art and Science Faculty of St. Petersburg Statutory University. Thus, in the view of CBR it has no impact on important corporate decisions made by MOEX shareholders' at the General Meeting or its Supervisory Board.

	<p>The CBR trading and trading supervision functions are carried out by different departments.</p> <p>Some products are specifically designed and supported by MOEX to trade with CBR only (Repo with CBR). In other cases, CBR uses the MOEX trading platforms (FX trading, FX swap, securities trading) used by all participants.</p> <p>Restrictions on the use by employees of CBR of proprietary information, including the use of confidential information, as well as personal data are set out in Article 92 of the law on CBR, as well as, in detail, in Position of CBR from July 8, 2015 No. 484-p "On commissions for compliance with the official conduct of employees of CBR and the settlement of conflict of interest; Instruction of CBR from July 10, 2014 No. 3414-u" On the procedure for the adoption of the employees of CBR of measures on the prevention and resolution of conflict of interest."</p> <p>Members of the Board of Directors are also subject to the restrictions imposed by Article 90.</p> <p>In addition to Article 90 employees are subject to requirements set out in a number of laws and other legal acts by CBR and the federal government, as listed below:</p> <p>The restriction on avoidance of conflict of interests and the detailed procedure thereon is stipulated in the following main acts:</p> <ul style="list-style-type: none"> • Federal Law on Anti-Corruption No. 273-FZ of December 25, 2008 (e.g., Articles 9–11, 11.1, 13.2); • Instruction of the CBR No. 3414-U of October 7, 2014 "On procedure for Taking by Bank Employees of Actions on Avoidance and Regulation of the Conflict of Interests"; • Instruction of the CBR No. 3336-U of July 22, 2014 "on procedure for Notification of the Employee Representative on Facts of Application for the Purposes of Corruption, Registration of Such Notifications and Verification of the Data Contained Therein"; • Regulation of the CBR Federation No. 438-P No. October 23, 2014 "On procedure for Notification on Gift Presentation Due to Official Position or Discharge of Duty, Handoff and Valuation of the Gift, Sale (Buy-Back) of the Gift and Transfer of Funds and Credit of Funds Received as a Result of its Sale"; • Regulation of the CBR No. 484-P of August 7, 2015 "On Compliance with Requirements to the Official Conduct of the Employees and Regulation of the Conflict of Interest"; • Order of the CBR No. OD-914 of November 18, 2013, pursuant to which the Commission on Compliance with Requirements on Official Conduct of the CBR Employees and Regulation of the Conflict of Interest of the HQ of the Bank of Russia has been formed;
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- In addition, on the website of CBR there is the separate section on anti-corruption (that includes issues on the conflict of interests as well) where there are other documents on the subject.

The restrictions on acquiring and disposing of securities by Bank of Russia employees are also set out in: Part 7 Article 11, Article 12.3 of the Federal Law on Anti-Corruption No. 273-FZ of December 25, 2008.

The requirement to disclose the financial position by CBR employees is established in the following acts:

- Regulation for Procedure on Inspections of the Accuracy and Certification of the Data on Income, Property, and Property-Related Obligations Submitted to CBR, Compliance by the CBR Employees with Requirement to the Official Conduct and Procedure for Control over Expenses, approved by CBR on August 20, 2013 No. 405-P;
- Order of CBR No. 3651-U of May 25, 2015 "On List of Positions that Requires Disclosure of the Data on Income, Expenses, Property and Property-Related Obligations" approved by CBR on May 26, 2015;
- Order of CBR of April 8, 2013 No. 2991-Y "On List of Positions of CBR that Persons Applied for and Occupied by the Employees of CBR that have to provide Data on Income, Expenses, Property and Property-Related Obligations as well as on Income, Expenses, Property and Property-Related Obligations of their Spouses and Minor Children";
- Regulation on Procedure on Provision of the Data on Income, Expenses, Property and Property-Related Obligations to the Bank of Russia, approved by the Bank of Russia on May 21, 2013 No. 399-P;
- Instruction of the Bank of Russia of July 16, 2013 No. 3027-U "On procedure for Placement of Data on Income, Expenses, Property and Property-Related Obligations by the Russian Mass Media for the Purposes of Publication;" and
- Regulation for Commissions on Compliance with Requirements on the Official Business and Regulation of the Conflict of Interests, approved by CBR on August 7, 2015 No. 484-P.

The obligation on employees to have regard to procedural fairness standards in performance of their duties is covered in other requirements and operational procedures of CBR as described in Principles 3 and 4.

Dealing with fragmented obligations and responsibilities

This fragmentation of obligations and responsibilities is a function of the operation of the Russian legal system. CBR cannot put it all into one document without risking accusations from

the public prosecutor of committing a serious legal violation by placing all the legal norms in a document that is not a legal act.

CBR has to work within this constraint and seeks to ensure that its staff understand their responsibilities. All new applicants are given information on what the expectations are. The individual officer has to sign document that they understand their obligations. There is a process for inducting new employees that ensures that they get the legislative requirements. It is for employees to familiarize themselves with their obligations.

On an ongoing basis, each staff member has a set of staff instructions. This describes their powers and duties, one of which is to follow the legal framework. New laws are sent to all departments. The head of department is obliged to ensure that all employees familiarize themselves with these new laws. To facilitate employee understanding the CBR website contains the legal texts, and includes explanatory notes and diagrammatic representations of the requirements and how to comply.

Operational and disciplinary processes

The operational conduct of CBR in these matters is governed by:

- Federal Law No. 59-FZ of May 2, 2006 "On procedure of consideration of application of individuals";
- Regulation for Commissions on Compliance with Requirements to the Official Business and Regulation of the Conflict of Interests, approved by CBR on August 7, 2015 No. 484-P; and
- Regulation for Procedure on Inspections of the Accuracy and Certification of the Data on Income, Property and Property-Related Obligations Submitted to CBR, Compliance by the Bank of Russia Employees to the Official Conduct and Procedure for Control over Expenses, approved by the Bank of Russian on August 20, 2013 No. 405-P.

In accordance with Article 88 of the Central Bank Law, CBR has set up a disciplinary system for employees as in CBR from July 22, 2014 # 3336-u "On the procedure for notifying the employee's representative about the facts concerning the commission of corruption offenses, the registration of such notification and verification of information contained in them." Under Article 90/1 nonperformance of the obligation stipulated in the article and failure to take measures for prevention or settlement of conflict of interest, to which he/she is a party, by a CBR employee holding a position included in the list approved by the board of directors is a violation of law punishable by termination of employment. As a part of its regular work CBR Human Resources and Personnel Management Department conducts inspections of CBR's employees' compliance with the requirements of the Russian Federation legislation and provisions of CBR Internal Code of Conduct in the course of exercising their functional responsibilities. In accordance with the information obtained, from the beginning of 2013 to

	<p>early 2016, at CBR's headquarters 38 people were held disciplinary liable, 19 of which were subject to disciplinary action notices, and the rest were given reprimands.</p> <p>Depending on the facts of the case other federal laws may be relevant such as Article 13 of the Federal Law on December 25, 2008 No. 273-FZ on combating corruption. Russian citizens, foreign nationals, and stateless persons for committing a corruption offenses incur criminal, administrative, civil, and disciplinary liability in accordance with the legislation of the Russian Federation. Sanctions include banning a person from occupying certain positions in State and municipal service.</p> <p>Definition of conflict of interest</p> <p>The law contains a definition of a conflict of interest as it applies to a state or municipal employee.</p> <p>Article 10. Conflict of interest in state and municipal service:</p> <ol style="list-style-type: none"> 1. In this federal law, the conflict of interest in state or municipal service is understood to mean any situation where personal interest (whether direct or indirect) of a state or municipal servant influences or can influence proper discharge by him/her of his/her official responsibilities and where a contradiction may arise between personal interests of the servant and rights and lawful interests of citizens, organizations, society or the state which can be to the detriment of rights and lawful interests of citizens, organizations, society or the state. 2. Personal interest of a state or municipal servant, which influences or can influence proper discharge by him/her of his/her official responsibilities, is understood to mean a possibility for the servant to gain, during the discharge of his/her official responsibilities, income in the form of money, values, other property or services involving property and other property rights for him/herself or for third parties.
Assessment	Broadly Implemented
Comments	<p>The references to restrictions applying only to "CBR employees holding a position included in the list approved by the board of directors" is not comprehensive as required by the principle which refers to "staff." Staff below middle manager level (e.g., below deputy head of division) are not included. Instead, staff members not included on the "list" are required to meet more general obligations such as in section 5.3 of the Regulation of CBR of July 25, 2003 N 235-P "Regulation on employees of Bank of Russia" which sets out that "if the holding of securities by the employee of Bank of Russia may lead to possible conflict of interest the employee is obliged to transfer securities he possessed to the fiducial management." There does not appear to be a good reason for this two tier approach.</p>

	<p>Reliance on the term “third parties” in Article 10(2) of the anti-corruption law referred to above could usefully be clarified by CBR to put beyond doubt that the constraints on staff apply equally to family members.</p> <p>Although reliance on a multitude of laws, regulations, instructions ordinances, etc., provides for the possibility of gaps and ambiguities CBR appears to have made substantial efforts to enable staff to understand their duties and responsibilities and the penalties for breach, etc. There is significant scope for providing greater clarity and minimizing the risk of inappropriate behavior thereby going undetected and unpunished.</p>
Principle 6	The regulator should have or contribute to a process to monitor, mitigate, and manage systemic risk, appropriate to its mandate.
Description	<p>CBR has a statutory obligation to monitor, mitigate and, where appropriate, manage systemic risk. Article 45 of the Central Bank Law requires the CBR to elaborate and pursue in collaboration with the government a policy of developing and ensuring the stable functioning of the financial markets of the Russian Federation. In order to do so it is required to monitor the state of the Russian financial markets, including for the purpose of detecting situations endangering the financial stability of the Russian Federation. Furthermore, to prevent the emergence of situations endangering that financial stability, CBR is required to develop measures aimed at reducing threats to that stability.</p> <p>The primary public document in which the CBR’s work in this area is made accessible to the public is the twice yearly FSR. The first updated edition covered 2014 Q4 2015 Q1. As of February 2016 the second edition, covering 2015 Q2 and Q3 was in the process of being translated into English.</p> <p>In the first updated review CBR discussed the December 2014 increased volatility in the stock exchange and FX markets and the stabilizing measures that CBR had taken in response. It also discussed the problem that professional securities markets participants had at that time in raising liquidity and the response of the NCC. It noted that CBR was tightening supervision over professional participants while also developing a mechanism to provide liquidity directly to brokers in crisis situations through repo transactions with central counterparties. This mechanism was intended to limit the spread of liquidity problems of professional participants during market shocks.</p> <p>Technical work on financial stability is carried out by the CBR’s FSD. It uses a dashboard for monitoring and assessing financial stability, including indicators of the state of financial markets and the banking sector. Thresholds are set for each indicator (in the yellow and red zones) at which CBR may take measures to mitigate systemic risk. Also under development is a list of risk factors for NFEs which including the performance of cross-sectoral issues (e.g., the size of investments in the stock market, performance etc.). The dashboard is updated at least monthly and submitted to FSC com members. In addition, CBR regularly studies international</p>

	<p>experience in terms of methods of risk analysis, financial stability and their possible use in the Russian Federation.</p> <p>Over a longer term time horizon, CBR is required to submit to the President and the State Duma once every three years draft guidelines for developing and ensuring the stable functioning of the financial markets of the Russian Federation. The State Duma considers the draft guidelines during a parliamentary hearing and sends its recommendations to CBR.</p> <p>CBR is the sole regulator of the financial market and supervisor of credit and non-credit financial institutions. However, in 2013 in order to coordinate the actions of state bodies and CBR, an inter-ministerial advisory body was established, the National Council on Financial Stability (NCFS), in which information is shared between agencies. The NCFS consists of representatives of the Presidential Administration, the Russian Federation Government, CBR, MoF, MED, and the State Deposit Insurance Agency. The NCFS meets at least quarterly and can commission work streams on topics on which it needs further information. The Secretariat of the Council consists of representatives of CBR, the MoF, and the government.</p> <p>In November 2014, CBR established a high-level internal FSC Com, chaired by the governor, to formalize and further strengthen macroprudential policy decision making. The FSC Com's responsibilities include:</p> <ul style="list-style-type: none"> (1) assessment and analysis of systemic risks and the stability of the financial system; (2) assessment and analysis of the financial sustainability of systemically important financial market infrastructures (FMI); (3) assessment and analysis of the financial soundness of the largest non-financial institutions, their financial risks and the impact of these risks on the banking system and financial markets; and (4) review of the draft FSR. <p>Total assets for all types of institutions recognized as shadow banking entities by the Financial Stability Board—FSB (NFIs and collective investment funds) amounted to US\$126 billion in 2014 in Russia that was 6 percent of total assets of the Russian financial sector, showing an increase in ruble terms though in dollar terms a decrease due to the significant ruble depreciation. Banks are still playing the key role in the financial sector, while alternative tools for savings such as money market funds are underdeveloped. Both private and corporate sectors continue to employ conservative investment strategies to manage their savings. Liquidity and maturity transformation risks are considered as the main risks of shadow banking entities in the Russia Federation.</p>
Assessment	Fully Implemented
Comments	<p>The FSR addresses systemic issues in all segments of the financial markets, including securities markets when they arise and these issues are given appropriate focus and analysis. Within CBR, nonbanking sector departments staff appear to be fully engaged in the work on systemic risk. FSC Com has a clear focus on NFEs and systemically important financial market infrastructure.</p>

	The NCC, the clearing house and central counterparty (CCP) of the overwhelming majority of the transactions in the financial market and a member of the Moscow Exchange Group, has been declared a systemically important financial institution (SIFI) as has the National Settlement Depository (CSD) which is also a member of the Moscow Exchange Group.
Principle 7	The Regulator should have or contribute to a process to review the perimeter of regulation regularly.
Description	<p>In evaluating the risks associated with the activities of financial institutions, as well as certain financial instruments, CBR analyzes the current regulatory standards, seeks to identify compliance risks and, if necessary, takes action to amend the legislation.</p> <p>Following the CBR's assumption of the role and functions of the single integrated financial markets regulator in 2013 it initiated a Task Force under the Russian Federation President's Council for Development of the Russian Federation's Financial Market. The Task Force prepared an initial list of 233 proposals submitted by the professional community for improving financial market regulation, which were ranked according to their assessed priority. Subsequently the Task Force's annual meetings have become a forum for the CBR's discussion with the professional community of priorities for the coming year, which increases the transparency and predictability of the regulator's actions and promotes effective cooperation with financial market participants. In addition, under CBR, in order to develop recommendations for setting strategy and policy regarding the development and regulation of the various segments of the financial markets, expert councils have been established consisting of representatives of the various specific communities and experts from the respective market segments. In particular, there are the following councils:</p> <ul style="list-style-type: none"> • Expert Council on Securitization of Financial Assets; • Expert Council on the Debt Securities Market; • Expert Council on Rating Agencies; • Expert Council on Internal Audit Regulation and Methodology, Internal Control and Management of Risks Posed to the Bank of Russia by Financial Institutions; • Expert Council on Insurance; • Expert Council on Collective Investment; • Expert Council on Microfinance and Credit Cooperatives; and • Expert Council on Financial Literacy in the Operations of Non-Lending Financial Institutions. <p>Out of this initial and ongoing work, which includes evaluating the risks associated with the activities of financial institutions, as well as certain financial instruments, perimeter issues emerge which CBR analyzes in terms of its investor protection and market stability remit, and its current regulatory standards. This includes analyzing risks associated with the activities of</p>

	<p>unregulated financial products, markets and market participants. It seeks to identify compliance risks and, if necessary, takes action to amend its regulation and, if necessary, to amend the relevant federal law.</p> <p>In this regard areas on which the financial markets departments have focused include the securitization market as regards the quality of the underlying assets, a possible market in agricultural infrastructure bonds, enhancement to derivatives markets instruments and regulation to reduce risk for retail investors. Identified areas of concern and examination, and possible new regulation are NFEs offering quasi-banking products and retail foreign exchange dealers. The microfinance sector, for which CBR is also responsible, also has some areas of concern.</p> <p>CBR also works on a cooperative basis with law enforcement authorities to counter Ponzi schemes. It has developed an analytical process which seeks to distinguish Ponzi schemes from legitimate financial products.</p> <p>Sources of information are professional markets participants, banks, SROs, Territorial Units, and complaints against NFEs and other entities. CBR also monitors foreign regulators websites for new instruments that may be raising concerns in other jurisdictions.</p>
Assessment	Broadly Implemented
Comments	<p>There may be scope for further formalizing the process of perimeter review to ensure that issues are not overlooked when they first emerge. This might include appointing a senior manager and staff with specific responsibility and appropriate reporting lines for the topic. One source of information is the Territorial Units of the Bank. In furthering its work on Ponzi schemes the bank might wish to consider, if it has not done so already, providing specialized training for these units to enable them better to recognize Ponzi schemes and other outright fraudulent practices. Typically, these are established in isolated and/or rural communities where the level of financial literacy is low and the opinions of respected community leaders who join these schemes early, either knowingly or in ignorance of the true facts, such as the priest, the doctor, etc., carry great weight. Some sophisticated schemes in some jurisdictions have been known to set up formal offices in small towns and have adopted all the trappings of a legitimate financial services firm.</p>
Principle 8	The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.
Description	<p>Central Bank Law (Article 4.1 states that CBR shall be obliged to elaborate and pursue a policy for preventing, detecting and managing conflicts of interests.</p> <p>Some provisions are in place. The Securities Markets Law (Article 3.2) states that if a conflict of interest between a broker and his client (of which the client had not been notified before the broker received the relevant order) has caused damage to the client, the broker shall be obliged to compensate for the losses. The client is required to go to court to get compensation and if successful CBR has also levied an administrative fine on the broker concerned. CBR is</p>

	<p>currently considering introducing a power whereby, when it determines that a client has lost money as a result of a broker's conflict of interest, it will by order instruct the broker on how to remedy the fault.</p> <p>There is no equivalent provision in the Investment Funds Law, although Article 2.2 states that CBR shall establish requirements aimed at preventing conflicts of interest of management companies and specialized custodians.</p> <p>There are no provisions to deal with the issue of balancing the interests of one client (or group of clients) against the interests of another client or group of clients such as arise in the investment banking area or in handling of client orders by a broker.</p> <p>The CBR Regulation of August 3, 2015 No. 482-II "Regulation on the common requirements of the rules of the management of securities to order the disclosure of information control, as well as requirements aimed at the exclusion of conflict of interests in the regulated," in Chapter 6 requires that the manager shall take measures to identify and monitor conflicts of interest, as well as the prevention of its effects; and that if the action taken by the manager to prevent conflict of interests have not led to a reduction in the risk of damage to the interests of the client, the client is obliged to notify the manager about the general nature and/or sources of conflicts of interest prior to the transactions which involved the management of the client's property.</p> <p>There are some specific prohibitions that have the effect of acting as constraint on actions that could otherwise result in an abuse of a conflict of interest. For example, under sub-paragraph 1(8) of Article 40 of the Investment Funds Law, the MC is not entitled to make transactions or give orders to make acquisitions of securities issued by its participants, its subsidiaries and affiliates, its specialized depository, its external auditor, the person maintaining the register of holders of units of its UIFs or shares in the share capital of any of these persons.</p> <p>Article 19 of the SRO Law requires an SRO to have rules that address conflicts of interest.</p> <p>Article 8 of the Auditor Law prohibits an auditor from committing actions that cause a conflict (or threat of conflict) of interest.</p> <p>Article 3(3) of the CRA law prohibits a CRA from conducting other activities that may create a conflict of interest and Article 3(9) creates a general obligation on CRAs to identify, manage, and disclose, or prevent conflicts of interest.</p> <p>The treatment of misaligned incentives, is addressed in CBR Instruction No. 154-I of June 17, 2014 on remuneration policy. This seeks to balance excessive risk taking and interests of the firm and employee as regards banks and non-state pension funds. It may be extended to broker dealers but only as a recommendation.</p>
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	<p>There are some provisions on how disclosure should be made, but tempered with the phrase “depending on the resources of the intermediary.”</p> <p>Regulation of the Federal Service for the Regulation of Securities (FSFR) as of November 15, 1998 No. 44 “Regulation on elimination of conflict of interests in the professional market participants’ activities” is still effective. It stipulates a general and broad definition of conflicts of interest.</p> <p>Conflicts of interest and cases of misaligned incentives are generally identified from complaints by investors that their rights have been violated; that is after damage has been caused. At that point CBR is able to take action including, if necessary, obtaining the necessary regulatory amendments.</p>
Assessment	Not Implemented.
Comments	<p>IOSCO has observed in the Explanatory Note to this principle that the critical issue from an assessment perspective is the process by which the regulator monitors conflicts of interest in the market that may have an effect on investor protection, market fairness, efficiency, and transparency, or pose a systemic risk. CBR lacks a process for identifying and evaluating such matters on an ongoing basis as is required by Key Question 1. Hence the downgrade. The view of the assessor is that CBR is not sufficiently proactive in identifying and evaluating potential, as distinct from actual and current, conflicts of interest and misalignment of incentives. Currently its responses are primarily reactive. The responsibility for identifying and taking action regarding losses caused by the mis-management of a conflict of interest by a professional market participant is placed on the client who may be unaware that they have suffered loss.</p> <p>The assessors have noted the difficulties under the Russian legal system in drafting provisions that impose on professional market participants an enforceable obligation to identify conflicts of interest and misaligned incentives, to take steps to avoid, eliminate (perhaps by declining to act in a transaction), disclose or otherwise manage them to and which enable CBR to provide non-exhaustive guidance on the situations and conduct which CBR believes constitute conflicts of interest or misaligned incentives. We however, strongly urge the authorities to seek a solution which would enable the Russian regulatory framework to move closer to international standards in this regard.</p> <p>The instruction on remuneration is currently limited to banks and non-state pension funds, which seeks to secure a balance between the risk to which a firm is exposed by the business generated by certain employees, and the rewards those employees receive, should be kept under review and, if appropriate, extended on a mandatory basis to broker dealers and fund managers.</p>
Principles for Self-Regulation	
Principle 9	Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence,

	<p>such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.</p>
Description	<p>Introductory note on the relevant legislation</p> <p>The main legislative provisions relating to SROs are set out in Law 223 of July 13, 2015 (the SRO Law), which came into effect on January 11, 2016, immediately before the mission. There are also provisions relating to SROs for securities market participants and exchanges in Articles 48–50 of the Securities Law and Articles 57–59 of Law 156 of November 29, 2001 on investment funds (the Investment Funds Law). The new SRO Law does not repeal the SRO provisions in the Securities Law or Investment Funds Law, although it covers all of the topics in those Articles (and more besides). The new SRO Law states that the provisions of Articles 50 (1) and 50(2) (which apply to SROs of forex dealers) of the Securities Law apply insofar as they do not contradict the new SRO Law. However, it makes no comment on the applicability of Articles 48 and 49 of the Securities Law or Articles 57–59 of the Investment Funds Law.</p> <p>The new SRO Law makes membership of an SRO mandatory for a firm engaging in an activity for which an SRO is registered. The provisions in the old laws were that membership was voluntary. Both sets of provisions remain in force.</p> <p>The provisions in the Securities Law and Investment Funds Law create license criteria for SROs and specify duties and obligations. Existing SROs have members who are professional securities firms and management companies. The license criteria and the list of SRO duties and obligations in the Securities Law differ from those in the Investment Fund Law (as set out in the description below). The general function of the SROs for professional securities firms and those for investment fund management companies are essentially the same. Some of the same organizations qualify as SROs under both. These SROs have to comply with the two different sets of requirements. There is no reason, relating to the functions of the SROs or the nature of the licensed activity, to justify these differences.</p> <p>The Securities Law contains provisions that could only apply to an exchange, acting as an SRO (Article 50: reference to “an entity that organizes trade”). CBR has explained that an exchange cannot be an SRO because an exchange must be a joint stock company whereas an SRO must be a non-corporate association. Nevertheless, the SRO provisions, relevant to exchanges, remain in place, although redundant by definition according to CBR. This contradiction has been in place at least since the Organized Trading Law was enacted in 2011 and there have been many amendments to the Securities Law since that time (including amendments to the SRO provisions) but the opportunity was not taken to remove this contradiction.</p> <p>CBR states that a bill to amend the existing provisions in the Securities Law and Investment Funds Law has now passed its first reading in the Duma. In the meantime, there is an overlap of provisions.</p>

The primary purpose of the SRO in the Securities Law (Article 48) is stated to be the protection of investors. However, the primary purpose of the SROs in the new law as specified in Article 3 is to promote the interests of the SRO's members as well as encouraging market development and efficiency. A full reading of the new SRO Law makes clear that, in fact, the intention is to create organizations that will become front line regulatory bodies whose job is to promote investor protection and fair markets. However, the new SRO Law changes the statutory definition of the purposes of SROs in precisely the opposite direction.

CBR states that the new SRO Law is in force but that at the time of the assessment, no SROs had yet registered under it. They continue to operate under the old laws. According to Article 33 of the new SRO Law, existing SROs that meet certain conditions will have a transitional period of two years to bring their arrangements into line with the new law.

The new SRO Law creates an obligation on professional securities firms to comply with basic standards of conduct that are adopted by SROs and approved by CBR. However, because the SROs have not yet registered, there are no basic standards. Moreover, even when the first SROs register under the new SRO Law, there will still be a period during which basic standards can be drafted, submitted for approval and implemented. The result is that there is an unambiguous obligation currently in place for professional securities firms to comply with basic standards but there are no basic standards in place with which they can comply. This position will resolve itself in due course. In the meantime, CBR confirmed that they would not take enforcement action for failure to comply with the non-existent basic standards.

- In summary, therefore, from the moment that the first SRO registers under the new law:
- The new SRO Law changes the statutory purpose of the SRO so that it becomes primarily concerned with the interests of its own members, rather than the protection of investors—a change that is in the opposite direction from that which is apparently intended by the new law taken as a whole;
- Membership of the SROs will be both compulsory and voluntary for professional securities participants and management companies;
- Professional securities firms will be obliged to comply with basic standards that will not, at that time, exist;
- Provisions relating to SROs that could only be relevant to exchanges will continue to be redundant since no exchange could be an SRO; and
- SROs who have members licensed under both the Securities and Investment Fund Laws will continue to be subject to two different sets of requirements as to license criteria and duties, as well as the new requirements of the new SRO Law.

	<p>Description</p> <p>The SRO regime is in a state of transition. This description will briefly describe the previous arrangements, which are still in force. It will then describe the new regulatory requirements affecting SROs under Law 222 of July 2015 (the new SRO Law) and then the transitional arrangements.</p> <p>The previous arrangements for SROs</p> <p>According to the Securities Law and Investment Funds Law, there are voluntary professional associations that are known as SROs. They must be granted a permit by CBR (Article 50 of the Securities Law and Article 59 of the Investment Funds Law). Both laws include a procedure for gaining permits and a set of criteria (which differed in the two laws, although not in ways that related to the differences between professional securities funds and investment fund management companies). There are currently four SROs for professional securities firms and management companies of investment funds.</p> <p>The purposes of the SROs for professional markets participants is defined in Article 48 of the Securities Law and is to promote standards of ethics and protect investors. Membership of the associations is voluntary under the Securities and Investment Funds Laws.</p> <p>The Securities Law states that SROs should have compulsory rules governing trading and conduct (Articles 49 and 50). The Investment Funds Law requires SROs to have binding rules (Article 59(2)) on performance of professional activity and ethics standards. The details of the areas to be covered by the rules are defined in the Investment Funds Law but not in the Securities Law. Both laws require SROs to enforce their rules and discipline members as necessary.</p> <p>The Securities Law SRO have to submit its rules (covering internal matters as well as standards and ethics for members) to CBR for approval (Article 50 of the Securities Law). There is no such requirement for SROs of management companies under the Investment Funds Law.</p> <p>In practice the SROs set standards for professional ethics and conduct. For example, the National Association of Securities Markets Participants (NAUFAR) set standards on such matters as best execution, the creation of a client investor profile, the risks that should be disclosed to clients, the prevention of conflicts of interest, and RM. These standards were reviewed and approved by CBR. In some respects, the NAUFAR standards copy the CBR regulations, in others, they provide more detail. Although NAUFAR states that it sought to enforce its rules according to the law, the fact that membership is voluntary means that a securities firm that does not wish to abide by the compulsory rules can simply resign membership.</p> <p>Ensuring compliance with the Securities and Investment Funds Laws is the responsibility of CBR. There has been no formal delegation of any regulatory responsibility to the SROs.</p>
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The SROs are given certain duties in the Securities Law and the Investment Funds Law, but these duties differ in some material respects. There is a prohibition on unjustified discrimination against SRO members in Article 50 of the Securities Law but not in the Investment Funds Law. The investment fund management companies' SRO can file petitions on behalf of its members to encourage CBR to give them a license (Article 58 of the Investment Funds Law) but there is no such right in the Securities Law for SROs of professional securities firms. The investment fund management companies' SRO must have rules for the expulsion of its members (Article 59(2)) but there is no such requirement on professional securities markets firms in the Securities Law, and, indeed, there is no statutory provision for applying sanctions.

The new SRO regime

The new SRO Law covers associations of brokers, dealers, investment funds, and management companies (as well as other nonbanking financial institutions) (Article 3(1)). This description will focus solely on the provisions relevant to professional securities markets participants and investment fund managers but the law has a much broader application.

The new SRO Law gives a more comprehensive regulatory role to the SROs. However, Article 3 of the new SRO Law defines the purposes of the SRO, which are to develop the financial market, contribute towards the efficient functioning of the market and stability, implement its own economic initiatives, and protect and represent the interests of the members. Although the SRO has the responsibility to apply basic standards, which are intended to force its members to act in a way that protects investors and encourage a fair market, these fundamental objectives of regulation are not included in the law's description of the SRO's fundamental purposes, which relate more to the interests of the members.

The new regime makes membership of an SRO compulsory (Article 8). Article 3 makes clear that there could be more than one SRO for every field of activity and each SRO could encompass members from more than one field of activity. However, every professional securities market participant and MC must be a member of one of the SROs (provided that at least one is registered for their field of activity). If a professional market participant leaves one SRO, they have 180 days to join another (Article 8(4)).

Each SRO would be expected to adopt internal standards and basic standards. Internal standards cover membership criteria, internal management elections, disciplinary processes, monitoring of compliance with standards and other administrative matters (Article 6). Basic standards cover RM, corporate governance, internal controls, investor protection, and market behavior (Article 5).

Internal standards are a matter for the SRO, and, provided that they do not breach the Law or regulations, are not subject to intervention by CBR. Basic standards are drawn up by a Standards Committee of the SRO (or SROs). They must be approved by CBR and, if approved, must be adopted by all SROs in any one field of activity. All professional securities market firms

in the relevant field of activity must comply with the basic standards, regardless of whether or not they are members of an SRO or in the 180-day transition from one to another.

Under these new regimes, professional associations that meet the criteria and become registered as SROs will establish membership criteria that firms seeking membership will have to comply with to conduct securities activity in the relevant area. However, the firm has the option which SRO to join if there is more than one for its activities. The SRO will have binding rules and must have arrangements for enforcing those rules and disciplining those who breach them (Articles 5 and 6 of the new SRO Law).

There are criteria for professional associations to become SROs and these are established in Article 3 of the new SRO Law:

An SRO must have 26 percent of the participants in the relevant field as its members;

It must have internal rules that do not conflict with the law or regulations and basic standards that follow those approved by CBR (discussed further below);

It must have appropriate governance arrangements as specified in the new SRO Law (Articles 20–25).

CBR has responsibility for reviewing the applications and granting or denying SRO status (Article 3). SROs that are approved by CBR will be entered on to the CBR SRO register.

CBR will review whether or not the internal standards comply with the law and this will encompass an assessment of whether or not they will enable the SRO to meet its commitment to enforce the internal and basic standards. The SRO must be able to collect information from members, conduct onsite inspections of its members (although not more than one scheduled inspection a year) and otherwise monitor compliance (Article 14). There must be a procedure for applying sanctions. The SRO must submit a budget, which CBR will review (Article 3(7)).

There are no explicit criteria relating to the capacity of the SRO to fulfill its duties, although CBR state that they will review that as part of the application review process.

Article 4(4)(4) of the new SRO Law states that the standards of the SRO Law must not allow any unjustified privilege to any member of the SRO, including the founders. This is intended to have the result that they treat all similarly situated members similarly and prohibit any SRO member from gaining advantage as a result of their membership or position within the SRO. It is further intended that this provision will ensure a fair representation of members on the management board.

Article 29 obliges the SROs to provide information to CBR on request and to supply CBR with a list of scheduled onsite inspections each year. Article 29 contains further provisions about the sharing of information on violations of the basic standards. The SROs can refer members to CBR for sanction and CBR can inform the SROs about breaches that may require their action.

Article 30 provides for the participation of the SROs in working groups considering new regulations. Article 31 provides for the SROs to form a Council for making representations on matters of interest to their members. There are no agreements or MoUs between the SROs and CBR at present nor are any envisaged, on the basis that the law establishes the grounds for cooperation.

CBR has a supervisory role with respect to the SROs (Article 28). This allows CBR to collect information from the SROs. There is no explicit provision that overrides the SRO's confidentiality duty to its members (Article 13) when CBR makes a demand for information under Article 28.

There is no explicit power of inspection in the new SRO Law. There is such an inspection power over SROs in the Securities Law (Article 44(6)). CBR initially stated that the exercise of such a power is implied by Article 28 of the SRO Law (although in all other laws, an inspection power is given explicitly). Subsequently, CBR stated that an explicit inspection power is included in a new bill.

CBR has the power to apply sanctions (including requiring the Head of the SRO be dismissed (Article 28) and to terminate the status of the SRO (Article 27). The powers of CBR to collect information from, inspect, sanction and otherwise take action against professional market firms and investment funds/management companies is in the Securities Law and Investment Funds Law and is not undermined by the new SRO Law.

The SROs are expected to protect the confidentiality of information collected from members (Article 13) although there are no other requirements regarding procedural fairness. Moreover, in the absence of any direct powers to intervene to change the rules that govern the SRO's internal processes, CBR cannot take action to ensure procedural fairness unless the SRO breaks the law or regulation, in which case, CBR can apply sanctions.

Article 19 obliges the SRO to have measures designed to prevent conflicts of interest in its Charter.

No supervision has yet been conducted under the new SRO Law because, at the time of the mission, no SROs had applied to be registered.

The transition

Professional associations have until the end of March 2016 to apply to register as an SRO. Associations that have been in existence more than a year before the law comes into force have two years to bring themselves to full compliance with the new SRO Law, although they are exempt from the requirement to submit a budget and do not have to demonstrate that they have 26 percent of those engaged in the relevant activity as their members.

	<p>CBR must approve basic standards, no later than three months after the first SRO is registered.</p> <p>In the meantime, CBR clearly cannot enforce the requirement that professional securities markets firms and investment funds/managers comply with basic standards, as there are no such standards yet in existence.</p> <p>Moreover, the existing provisions relating to SROs for professional securities markets firms and investment funds/managers, remain in force. The SROs and their members will continue to be subject to the provisions in the Securities Law and Investment Funds Law as described above. CBR has said that it will not enforce the provisions that are inconsistent with the new law, just as it will not enforce the requirement to comply with basic standards, since they do not yet exist.</p>
Assessment	Not Implemented
Comments	<ul style="list-style-type: none"> • The new law contradicts provisions in existing laws but does not repeal or amend those pre-existing provision. The inconsistencies between the existing provisions in the Investment Funds Law and Securities Law, the conflict and inconsistencies between those provisions and those in the new SRO Law (all of which are currently in force), the transition period, during which existing SROs do not yet have to register under the new SRO Law and CBR has not yet adopted basic standards, (even though it is compulsory for professional securities firms and fund managers to comply with them) all add up to what can only be described as a highly confused picture. It is not appropriate to put licensees (or indeed anyone else) in the position that they are faced with mutually incompatible or inconsistent legally binding requirements. CBR has stated that Russian legislative principles with respect to legal precedence can deal with inconsistencies between laws and that they will not enforce mutually incompatible legal requirements. • However, this is not an appropriate response. It is not impossible to bring new legislative requirements into effect in a way that repeals former and inconsistent provisions and gives transitional arrangements that clarify the legal requirements that are in place at any time and ensures that they can be met. Relying on principles of legal precedence creates uncertainty about the legal provisions in place and forbearance by the regulator undermines respect for the regulatory regime and the rule of law. CBR have stated that legislation to remove the inconsistencies is before the Duma but this begs the question as to why such amending provisions were not included in the law amending the SRO regime in the first place. • The rating is given because: • The conflict means that CBR cannot enforce the old regime. • The new regime also cannot be enforced because of the absence of several key elements (SRO registration, the adoption of basic standards).

- The description identifies a number of important gaps in the new law that will need to be filled to ensure that the SROs are subject to provisions to ensure effectiveness and that CBR has the full range of monitoring powers. In particular:
- Although SROs are expected to impose basic standards of regulation, their primary purpose, as described in Article 2 of the SRO Law, is not investor protection, but the development of the market and the protection of their members' interests. This is not appropriate. Their primary purpose should be to raise standards of professional conduct and to protect investors (as is still the primary purpose of SROs as defined in the Securities Law). CBR have rightly pointed out that the law requires SROs to adopt basic standards which will include requirements that protect investors. However, this misses the point that the primary purpose of SROs, as stated in the law, is not the protection of investors or the maintenance of high standards of professional behavior but is the protection of members interests and this is a significant mistake. All SROs have a tension between their role to protect their members' interests and their duty to impose duties on and discipline members for failing to comply with, rules that protect investors. If the law itself gives primacy to their role as defenders of their members' interests, then this is bound to affect the way the tension between the SRO roles is resolved in practice.
- CBR does not have the power to make an assessment of the capacity of the SRO to fulfill its function.
- The single provision prohibiting unfair privilege (and the obligation to put conflicts of interest provisions in the SRO Charter are important but are not sufficiently explicit to encompass the requirement to treat all SRO members equally, to avoid any unfair competitive advantage being taken as a result of the supervisory role, to avoid creating barriers to entry or to avoid inappropriate use of information obtained through the SRO work.
- There are no provisions that oblige SROs to adopt standards of procedural fairness.
- CBR does not have the explicit power to intervene to amend the internal rules of the SRO to ensure procedural fairness and to approve or deny approval to any changes to the SRO internal rules.
- There is no record keeping requirement for SROs beyond the keeping of a register of members.
- There is no explicit power in the new SRO Law for CBR to conduct onsite inspections of SROs.
- There is no explicit provision that ensures the CBR power to collect information from the SRO overrides the SRO's duty of confidentiality.
- It is fair to point out that the expectation that there will be competing SROs in each field of activity will work to reduce the risk of membership criteria being a barrier to entry. On the other hand, competition creates another incentive to regulatory

forbearance if the SRO considers that excessive zeal will prompt members to join a competitor SRO. In the view of the assessors, the requirement that an SRO must have members comprising 26 percent of the securities firms in the relevant field of activity, before it can be registered, will be a very significant barrier to any new SROs. Each member is legally obliged to be a member of an SRO, so a new SRO would have to persuade securities firms to join (and presumably pay fees) while still being members of an existing SRO—unless securities firms were prepared to resign from one SRO and take the risk of a new SRO being registered within 180 days of their resigning (this being the maximum period that can remain as non-members of a registered SRO).

- CBR considers that the risk of SRO's creating barriers to entry, or using the regulatory powers to gain competitive advantage will be mitigated by the provisions in place and supervision by CBR. The assessors agree that it is unlikely that SROs will create rules or membership criteria that are explicitly discriminatory or manifestly biased towards existing members. However, experience shows that SROs can and do find it difficult to address the conflict of interest in their status as a professional association of members and a regulatory authority. As noted above, this potential conflict is exacerbated by the primacy given to the SRO and their members' interests in Article 2 of the law.
- Recommendations to fill these gaps are set out below.
- CBR has not yet finalized its view of the extent of the regulatory role to be given to SROs and stated that they will consider the effectiveness of SROs in operation under the new SRO Law before coming to a decision. In the meantime, CBR will continue to enforce its own regulations. Although CBR is resolved to avoid duplication, the fact is that the scope of the basic standards, as defined in the SRO Law, covers ground that is also addressed through a multitude of laws, CBR, regulations, directions and instructions. While CBR will no doubt ensure that the basic standards do not directly contradict the regulations already in place, professional securities markets firms and the investment fund management companies will be subject to two sets of requirements.
- CBR should consider what supervisory tools it should use to oversee the work of SROs. In addition to offsite analysis, there is scope for regular meetings with the management of the SROs, more extensive reporting on the SRO activity, a combination of joint onsite inspections of firms and independent inspections to check on the effectiveness of the work done by SRO's onsite inspectors and to determine the level of compliance of securities firms subject to SRO supervision. CBR should develop a program of supervision that deploys all of these tools and does not simply focus on finding violations that can then be the subject of sanction.

Recommendations

- It is recommended that, as a high priority, the legal position is clarified as soon as possible with the conflicting provisions amended or repealed, new regulations adopted and SROs registered under the new SRO Law.
- It is also recommended that the SRO Law be amended to include the following basic provisions:
- That the primary purpose of SROs (Article 2) should not be the advancement of the interests of their own members but the implementation of high standards of professional behavior and investor protection;
- That an explicit condition of registration of an SRO should be the ability to demonstrate to CBR that an SRO has the willingness and capacity to provide adequate standards of professional behavior and investor protection;
- That an SRO should adopt provisions that prevent any member of the SRO, or any employee from abusing their position to gain unfair competitive advantage;
- That the SRO's internal rules should include provisions on procedural fairness that match those of CBR itself and a prohibition on the inappropriate use of information, for example for personal gain;
- That the SRO's internal rules should ensure that all similarly situated members and applicants should be treated equally;
- That the membership criteria for the new SROs should not constitute a barrier to entry to the securities or fund management business;
- That the SRO should be required to submit its internal rules to CBR for approval and that CBR should be able to approve, deny approval or insist on changes to the SRO's internal rules, where necessary to ensure that they match appropriate standards of fairness, effectiveness and professionalism;
- That the SRO should be required to keep records, for a minimum of five years, which demonstrate that it is complying with its charter and its statutory responsibilities and which record the operation of its functions;
- That CBR has the power to conduct onsite inspections of SROs; and
- That the power of CBR to collect information from SROs overrides any confidentiality duty imposed by the SRO Law or any other statute.
- It is further recommended that:
- CBR develop, with the SROs, standards for the supervision of members that uses all supervisory tools, including meetings with management, the issuance of guidance letters and public statements, periodic reports of information, including members risk assessments, corporate governance practices, client agreements, internal staff training,

	<p>complaints received from clients and other matters, the use of questionnaires and different methods of onsite inspection;</p> <ul style="list-style-type: none"> • The basic standards, as adopted by CBR should replace, rather than add to the existing regulatory regime, as soon as CBR consider that the SROs can safely be entrusted with the regulatory regime; and • CBR develop a program of supervision of SROs designed, particularly, to address the key risks of barriers to entry and the gaining of advantage that includes regular meetings with management, regular reviews of the operation of its internal and basic standards, in practice, seeks reports that monitor effectiveness, (for example of the SRO’s risk assessment so of its members, of the number of complaints, of the number of inspections and sanctions and the nature of the regulatory breaches that it finds) as well as onsite inspections of SROs and onsite inspections of the professional securities firms subject to SRO supervision.
<p>Principles for Enforcement of Securities Regulation</p>	
<p>Principle 10</p>	<p>The regulator should have comprehensive inspection, investigation and surveillance powers.</p>
<p>Description</p>	<p>CBR has the full range of inspection, investigation and surveillance powers needed by a securities regulator.</p> <p>The Central Bank Law gives CBR the responsibility for supervision of a range of non-credit institutions (Article 76¹), including: professional securities firms, investment fund management companies, custodians, registrars (keepers of the investor registers for companies and other entities), investment funds, exchanges, clearing houses, central counterparties and credit rating agencies. Article 76⁵ specifically gives CBR the power to conduct onsite inspections. Article 44 of the Securities Law gives CBR supervisory powers over all professional securities firms (brokers, dealers, investment managers, custodians, and registrars (Articles 3–8). Article 44(6) specifically provides for an onsite inspection power over these firms. Moreover, Article 2 of the Investment Funds Law makes clear that the law covers investment funds that invest in any securities and other assets. Article 55(3) gives CBR an inspection power over investment funds, management companies and special depositories (custodians). There is also an onsite inspection power for CBR in Article 25(2) of Law 325 FZ of November 21, 2011 on Organized Trading (the Organized Trading law). An onsite inspection power over clearing houses is given in Article 25 of Law 7 of February 7 2011 (the Clearing Law).</p> <p>Some of the provisions listed above make distinctions between scheduled and unscheduled inspections. Where this distinction is made, scheduled inspections cannot be made more than once a year and unscheduled inspections can only be made if certain conditions are met essentially that there is a complaint or other suspicion of a breach or, in some cases, the need to follow up the findings of an earlier inspection. Where there is a suspected breach, the visit by the supervisor would be regarded (in terms of the analysis of Principle 10) as an investigation rather than an inspection. These distinctions between scheduled and unscheduled</p>

inspections are made in respect of the inspection powers in the Investment Funds Law (Article 55(3)), the Clearing Law (Article 25(2)) and the Organized Trading Law (Article 25(2)). There is no such qualification in the inspection power in the Central Bank Law with respect to non-credit institutions (Article 76⁵). There is no such restriction in the inspection power over professional securities firms in the Securities Law (Article 44). CBR were unable to provide an explanation for the restriction nor for the differences between the different laws other than that they were drafted at different times. There remains scope for unscheduled inspections without notice in these laws, although they must be arranged for the purposes specified above.

The supervisory powers listed above also give CBR the power to obtain books and records and request data or information (Article 76⁶ of the Central Bank Law, Article 44(7) of the Securities Law, Article 55(13) of the Investment Funds Law, Article 25(5) of the Organized Trading Law) and Article 25(4 and 5) of the Clearing Law. These powers could apply to ad hoc enquiries or regular reports and apply to the full range of securities businesses.

The Organized Trading Law obliges the exchange to conduct supervision including surveillance of trading (Article 5). The inspection power given to CBR (Article 25) gives CBR unrestricted access to the exchange to oversee that surveillance. The power of CBR to get information from the exchange (Article 25) enables it to obtain information on trading and trading surveillance. In addition, paragraph 32 of Appendix 4 of Regulation 474 provides that a remote terminal should be supplied to CBR. As described in Principle 36, this facility, together with other information supplied to CBR, permits it to conduct surveillance. CBR continues to develop the effectiveness of the system. CBR can also seek information from the exchange about its own surveillance results.

Law 402 of December 6, 2011 on Accounting (the Accounting law) applies to a very wide range of entities including regulated businesses. This Law imposes a general requirement to keep accounting records that should include all facts of economic life (Articles 5 and 6 of the Accounting law). These records must be kept for five years (Article 29).

Although there is a general record keeping provision in Article 401 of Law 395 of December 2, 1990 on Banking (the Banking Law), and Article 9 of the Clearing Law, there is no equivalent general record keeping obligation in the Securities Law, the Investment Funds Law or the Organized Trading Law. CBR were unable to explain the reason for this different approach.

There are a range of specific record keeping requirements including the following:

- Article 3(3) of the Securities Law obliges brokers to keep records of client monetary assets;
- Article 5 obliges an investment manager to keep records of securities under management;

	<ul style="list-style-type: none"> • Article 7 obliges a depository to keep records of the rights to securities held in another depository and the funds deposited by depositors; • Article 28 observes that the nominal rights of ownership of shares should be kept by the registrar of the issuer (the registrar has records of the nominal owners and the intermediaries who hold securities on behalf of others but not the beneficial owners); • Article 13.1 of the Investment Funds Law requires investment managers to keep records of the funds of clients; • Article 15.2 requires an investment manager to keep records of the rights to securities making up the investment trust. • Article 28 requires an agent to be responsible for the recording of investment share acquisition, redemption, etc. • Article 39 requires a MC to keep records of operations in the property making up the assets of the investment fund. • Article 47 refers to a register of the shares in an investment trust. • Article 5(12) of the Organized Trading Law obliges the market operator to store information and documents associated with the performance of organized trading. • Article 18 of the Organized Trading Law obliges an exchange to keep records of all trades. • FSFR Decision No. 32 of December 11, 2001 (the Deals Recordkeeping Order) consists, in its entirety, of extremely detailed and comprehensive record keeping requirements relating to securities transactions and includes all relevant details, including the time, date, price, volume, client details (including the person acting on behalf of the client and the person handling the transaction), as well as the means of payment from and to client bank accounts. The Regulation also requires that such records be kept for five years (paragraph 13). <p>Article 7 of law 115 of August 7, 2001 on the AML law) imposes a requirement to obtain and keep records of client identity. There are certain exceptions to this rule—namely where transactions involve less than RUB 15,000 (US\$200) (Article 7(1.1, 1.2 and 1.4). The client identity records would also need to be kept for five years after termination of the relationships (Article 7(4)).</p> <p>Provided that the records on client identity are maintained, CBR can have access to them using the broad powers in Article 76⁶ of the Central Bank Law, Article 44(7) of the Securities Law Article 55(13) of the Investment Funds Law, Article 25(4) of the Organized Trading Law and Article 25(4) of the Clearing Law). Each of these applies broadly and would permit CBR to obtain any information including client identity. CBR is also the bank supervisor and has full access to bank records.</p>
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	As noted in the description of Principle 9, the legislation regarding SROs is in a state of transition. At the time of the assessment, SROs had not registered under the new SRO Law. The issue of supervision of SROs to which regulatory authority might be delegated is not applicable as no such delegation had taken place at the time of the assessment.
Assessment	Fully Implemented
Comments	<p>The absence of a general record keeping requirement for securities firms and exchanges could result in a downgrade of the rating. However, the combination of the general record keeping power in the Accounting Law and the extensive specific record keeping requirements in the various laws meets the criteria for this principle. In particular, the records kept are capable of tracing funds and securities into and out of bank and brokerage accounts.</p> <p>Recommendation</p> <p>Even though it can be shown that the record keeping requirements that are to be found in various regulations and other provisions meet the terms of this principle, it would still be appropriate for CBR to seek an amendment to the Securities Law, Investment Funds Law, Organized Trading Law, and Clearing Law that imposes a general requirement on all securities businesses to keep such records as would be necessary to demonstrate their operation of their business, to demonstrate compliance with the law and regulations, to document their relations with clients, and third parties and to keep such records for five years.</p>
Principle 11	The regulator should have comprehensive enforcement powers.
Description	<p>Regulated persons</p> <p>The CBR's powers to monitor compliance with laws and regulations by collecting information and conducting onsite inspections are described in Principle 10. These powers would also enable CBR to conduct investigations into breaches of the law and regulation by regulated securities firms.</p> <p>There is no restriction on the information that can be obtained by CBR for its supervisory purposes either through inspections or obtaining information. Moreover, as noted in the description of Principle 10, there are record keeping requirements in the Deals Record Keeping Order (32) that oblige securities firms to keep records of transactions, including the time, date, price, volume, client details, the person acting on behalf of the client (and the person handling the transaction), as well as the means of payment from and to client bank accounts. The regulation also insists that such records are kept for five years. Since these records are available, CBR would be able to obtain this information.</p> <p>The Central Bank Law and the Securities Law both give CBR powers to direct a regulated entity to correct breaches (e.g., Article 44(7) of the Securities Law and Article 74 of the Central Bank Law). Similar authority is given in the Investment Funds Law in respect of investment funds, management companies, custodians, and other regulated persons (Article 55(2)(13) of the Investment Funds Law. Article 25 of the Organized Trading Law includes a similar power to</p>

send a compulsory order (within its competence) to a person where this is necessary to prevent a violation. A similar power is given in the Clearing Law (Article 25).

Law 9 FZ of February 9, 2009 on Administrative Offenses in respect of companies and securities laws (The Administrative Offenses Law) describes administrative sanctions for certain offenses which may be committed by issuers and professional stock market participants, such as document maintenance (Article 13.25), improper issuance (Article 15.1), unlawful transactions (Article 15.18), disclosure failures (Article 15.19), improper use of official information (Article 15.21), failure to segregate client assets, keep records, and various other offenses, including "any other failure" (Article 15.29). These attract various fines and disqualifications. The sanctions on natural persons can be up to RUB 50,000 (US\$750) and disqualification for up to two years and for legal persons, the fine can be up to RUB 1 million (US\$14,000). The sanctions can be imposed for failure to comply with requests for information.

Unregulated persons

CBR has powers to collect information from issuers (Article 44(7) of the Securities Laws). This is not restricted and could include any information related to any matter within the jurisdiction of CBR. Under Article 25(4) of the Organized Trading Law, CBR may require any natural or legal person as well as the trading organizers) to give information in connection with organized trading.

CBR can also mount investigations into allegations of breaches of the laws on market abuse, when conducted by unregulated persons by virtue of Article 16(1) of the Law 224 of July 27, 2010 on Insider Dealing (the Insider Dealing Law). It can also refer any matter within the jurisdiction of CBR to the Public Prosecutor under Article 44(8) of the Securities Law. Front running is included within the definition of insider dealing (see Principle 36).

Other securities fraud would be covered by the fraud sections of the Criminal Code and would fall to be investigated by the law enforcement authorities.

In addition to the powers in the Insider Dealing Law, CBR state that they can also use the powers in Article 11 Law 46 FZ of March 5, 1999 (the Investor Protection Law). These powers would, according to CBR, enable them to obtain information from unregulated persons.

The investigative powers referred to above are not limited as to the nature of the information that can be obtained. Thus for regulated entities, in the case of investigations into insider dealing or market manipulation, CBR can obtain any information, including the records necessary to reconstruct transactions, client identity, price and volume, time and date, the names of the parties, beneficial owners, and so on. There is no restriction on obtaining bank records. For unregulated persons, the CBR's powers are not restricted as to the nature of the information to be collected from issuers (on any matter) or, for market abuse) from any person.

The public prosecutor's powers are not restricted as to the nature of the information that can be obtained, provided that the information is available in the Russian Federation.

With respect to beneficial ownership, CBR has the power to obtain the beneficial ownership of any legal person. However, this can only be effective, where that information is located in the jurisdiction. Under Article 28 of the securities Law, the registrar or a company must hold records of the nominal owners of securities, including natural persons and intermediaries, trust managers and depositories. However, the clients of those intermediaries are confidential. Article 8.3 of the Securities Law give the registrar the power to require intermediaries to provide certain details about the ownership of securities, including those who are on a list of those who can exercise the rights of ownership. Where the nominal owner is a foreign entity, the obligation is only to provide data on the name of that foreign entity, even if it is a nominee.

Under the AML Law (Article 7), a regulated person is obliged to obtain beneficial ownership information and record it. The AML Law includes a general requirement to identify the beneficial owner (Article 7) and this is defined in Article 2 to include any person with a direct or indirect control of 25 percent of the shares of a legal entity or other possibility of controlling the legal entity. However, for a natural person, the law permits the institution to assume that a natural person is the beneficial owner unless there are reasons for supposing otherwise. Moreover, Article 7 also says that if "affordable" measures are taken and still do not identify the beneficial owner, the executive body of the legal entity can be assumed to be the beneficial owner. Such provisions are likely to result in cases where the beneficial owner is not identified—especially if the Russian legal entity is owned by a foreign legal entity.

Moreover, there is no specific requirement in the Deals Recordkeeping Order to keep a record of the beneficial owner of the securities.

Although there is no direct power to collect an oral statement, CBR can obtain information and explanations from non-regulated persons (Article 14(1) of the Insider Dealing Law. The powers in Article 76⁵ of the Central Bank Law are also broad enough to encompass the taking of oral explanations.

Under Article 185.3 of the Criminal Code of the Russian Federation market manipulation involving large losses to others or large profit or avoided loss (in excess of RUB 2.5 million (US\$37,000)) is punishable with a fine in an amount from RUB 300,000 to RUB 500,000 (US\$7,000) or one to three years' salary or imprisonment for a term of up to four years with a fine in an amount of up to RUB 50,000 (or up to three months' salary) with subsequent restrictions on professional activities for up to three years. In particularly serious cases involving a group of individuals or very large losses to others or very large profit or avoided loss, (in excess of RUB 10 million US\$150 million), the fine may be from RUB 500,000 to RUB 1,000,000 (US\$14,000) or two–five years' salary or imprisonment for a term from two to seven years with a fine in an amount of up to RUB 100,000 (US\$1,400), or up to two years' salary with subsequent restrictions on professional activities for up to five years.

	<p>Under Article 185.6 of the Criminal Code the illegal use of inside information involving large losses to others or large profit or avoided loss (in excess of RUB 2.5 million (US\$37,000)) is subject to similar criminal penalties and includes the offense of “tipping off” another person to make a transaction.</p> <p>If an offense is not punishable under the criminal law administrative fines are lower. For legal entities, according to Articles 15.21 and 15.30 of the Administrative Offenses Code of the Russian Federation, the fine is the profit or avoided loss but no less than RUB 700,000 (US\$10,000).</p> <p>Penalties also apply to those who refuse to give information when required to do so by CBR (Article 19.7.3 of the Administrative Offenses Code of the Russian Federation).</p> <p>There is a further power to seek court and judicial orders, in Article 44(8) of the Securities Law.</p> <p>Article 21 of the Organized Trading law obliges the exchange to stop trading when required by law or regulation and if it receives an order from CBR. This applies to any securities. Article 25(2) of the Securities Law provides for the suspension of trading by CBR. This enables CBR to require the exchange to suspend trading of an issuer that has failed to comply with its obligations under exchange rules or the law. The suspension could apply to an individual security or to the entire market. The power can be exercised if the exchange itself has failed to abide by its obligations.</p> <p>Article 7(7) of the Insider Dealing law expressly permits those who have suffered loss as a result of insider dealing or market manipulation to claim compensation. In other respects, there are no restrictions on the ability of private persons to take legal action against securities market participants if they choose to do so.</p> <p>As noted above, CBR can pass matters to the public prosecutor. There are established arrangements for sharing information with the public prosecutor. Information exchange with the public prosecutor is permitted under the Presidential Decree 224 of March 3, 1998.</p> <p>Interviews with the MoI demonstrate that relations between the ministry and CBR are good and that information can be and has been exchanged.</p>
Assessment	Broadly Implemented
Comments	<p>The rating is given, because of the provision that may result in beneficial ownership information not being available to CBR. The assessors have also taken account of the fact that there have been virtually no insider dealing prosecutions.</p> <p>CBR have observed that they have sufficient powers to obtain information about beneficial ownership from regulated persons. This is understood and explained above. However, it misses the point that a power to obtain information cannot be effective if the information is not there.</p> <p>As noted above, the current AML Law allows regulated persons to make assumptions about</p>

beneficial ownership and this is bound to result in them not knowing the beneficial owners of certain clients—especially legal persons incorporated in foreign countries. The CBR's further observation that they can get beneficial ownership information direct from foreign regulators is optimistic but experience shows that such information can by no means always be obtained in that way. Indeed, in their comments, CBR refers to the countries with whom it has bilateral MoUs and there are many countries with which it does not have such an agreement.

The powers available to CBR with respect to regulated persons are clearly extensive and are being used. It is clear that the use of the supervision powers with respect to the exchange have not been fully used in the past, they are being developed and CBR deserve the credit for having taken the initiative. It is enhancing its market surveillance technology and engaging with the exchanges on the best way of developing that surveillance. It has not yet been able to achieve successful criminal prosecutions for market offenses but the same is true of many countries with a lot more experience of enforcing market abuse offenses than the CBR. The fact is, however, that the powers and facilities to monitor the market and to detect and investigate market offenses are available and are beginning to be used.

With respect to unregulated persons, CBR has sufficient investigative powers over issuers and to any other person for any matter connected with organized trading and to market abuse. For any other matter within its jurisdiction, CBR has the power to refer an investigation to the public prosecutor.

CBR are clearly developing their knowledge of the market and their relations with law enforcement authorities so as to make their use of enforcement powers more extensive.

CBR have shown their willingness to use their powers to cancel licenses of regulated persons.

The financial administrative sanctions available to CBR are fairly modest but the ability to withdraw a qualification certificate and hence, ban a person from employment within the securities business for three years is a powerful penalty. This penalty has been imposed in practice. Similarly, criminal financial penalties are relatively modest but the maximum fine is related to the income of the offender and the scope for prison sentences mean that the sanctions appear to be potentially effective, proportionate, and dissuasive. At the time of the assessment, the more severe criminal penalties had not been imposed but the assessors have taken account of the fact that the law is relatively recently enacted.

The assessors would also comment on the use of the powers in the Investor Protection Law. The powers are given in Article 11 which reads as follows:

1. *The rulings of the federal executive body in charge of securities markets [now the CBR] shall be mandatory for execution by commercial and noncommercial organizations and their officials, independent entrepreneurs, natural persons on the territory of the Russian Federation.*

2. Directives of CBR shall be issued on matters envisaged by this federal law or other federal laws, in order to stop and prevent violations of the Russian Federation legislation on joint-stock companies and on securities market, as well as on matters within the competence of CBR.

Whenever a violation of rights and legitimate interests of Investors by a Professional Participant are revealed, or if activities of a Professional Participant jeopardize the rights and legitimate interests of Investors, CBR shall be entitled to prohibit or restrict individual operations carried out by the Professional Participant at securities market for the term of up to six months.

This is an extremely broad power which appears to allow CBR to instruct any person (legal or natural) to do anything within its competence and that they have to comply. CBR have stated that this power is qualified by the next paragraph in the article that refers to the need to stop violations of the Law on Joint Stock companies and securities markets laws. However, CBR have, in other contexts, stated that this qualification does not apply, since the law also refers to any matters within the CBR competence, regardless of whether or not it is intended to prevent violations of Russian laws on joint stock companies and the Securities market.

This latter, very broad interpretation of this law is necessary because these powers have been referred to in support of the CBR's application to become a signatory to the IOSCO MMoU. In that context, CBR stated that this power would enable them to obtain information from unregulated persons. Since CBR already has powers to collect information from unregulated persons in the context of investigations into insider dealing and market manipulation (Article 14 of the Insider Dealing Law) the reference to the broad powers in the Investor Protection Law could only be relevant where CBR was being asked to obtain information from unregulated persons in respect of matters not connected to insider dealing and market manipulation and perhaps not connected with any offense under Russian law at all.

However, CBR have also stated that they could not use very broad powers in Article 11 in practice. In the description of Principle 30, it is noted that CBR consider that they could restrict the activities of professional securities firms using the specific power in the second paragraph of Article 11(2). However, they did not consider that it would be safe to attempt to use Article 11 powers to transfer client assets from one broker to another where the broker's level of capital put its continued survival at risk. Such action would clearly be covered by the broad interpretation of the CBR's powers, since it would be to protect investors and would be within the CBR's general competence. Nevertheless, it was argued that, in the absence of a specific provision in the law (and given the general reluctance within the Russian judicial system to enforce broad and undefined powers of this kind), it would be unsafe to use the powers for such a purpose.

The assessors cannot come to a conclusion on the scope of this power, legally. They would note, however, that if Article 11 can be interpreted so broadly as to give CBR powers to collect information from unregulated persons in circumstances not otherwise envisaged in any of the

	<p>laws (except perhaps implicitly and indirectly in Article 51¹ of the Central Bank Law) then they could also be used for the transfer of assets from one broker to another—since the latter is clearly covered by the need to protect investors, which is a matter well within the CBR’s competence. On the other hand, if CBR is right that the powers cannot be used to transfer assets, then it is hard to see how they could be used in the way suggested in the MMoU application.</p> <p>Nevertheless, even if the powers cannot be used to collect information from unregulated persons, the other CBR powers in the Insider Dealing Law would appear to be sufficient for this purpose with respect to market abuse. The powers over issuers and users of organized markets provide further investigative powers over unregulated persons for CBR and, were these not sufficient, the powers of the public prosecutor are available as CBR can refer anything within its jurisdiction to the public prosecutor.</p> <p>Recommendations</p> <p>CBR is recommended to seek an amendment to the AML Law so that a person subject to the relevant obligations should:</p> <ul style="list-style-type: none"> • Always ask a natural person if they are acting on their own behalf or on behalf of another; and • Refuse to act if they are unable to identify the beneficial owner of a legal entity. <p>CBR should consider reviewing the powers in Article 11 of the Investor Protection Law and seeking an amendment as appropriate so that they are capable of being used in the circumstances where CBR requires them.</p>
Principle 12	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	<p>The CBR’s supervision and enforcement program consists primarily of offsite supervision and onsite inspections. The offsite supervision is conducted by specialists in capital market activity. The inspection team carries out inspections of all activity regulated by CBR and this amounts to over 19,000 non-credit financial organizations in all financial sectors.</p> <p>The offsite department analyses information from periodic reports (primarily financial data), complaints, reports of violations and other intelligence to determine a six-month inspection plan. They develop a set of objectives and tasks and discuss them with the onsite team.</p> <p>The offsite team does not yet produce a comprehensive risk scoring of intermediaries that takes into account the adequacy of RM, internal controls and procedures (except for compliance with the limited and detailed provisions in the internal controls regulation) or any broader view of the quality of management and its compliance culture. However, as noted in Principles 24 and 31, there is a move towards a risk-based approach, particularly with respect to</p>

the development of a program aimed at identifying and removing from the business those intermediaries that carry out limited or no business.

CBR carries out onsite inspections. The inspection team, which has 250 staff to inspect over the 19,000 non-credit financial organizations for whose supervision CBR is responsible. The team does not have any dedicated capital markets specialists. The inspection team consists of staff in headquarters and in the regions (territorial units). This team was formed of:

employees of Federal Service of Financial Markets, which are financial markets specialists and which were transferred to CBR due to transference of the functions of supervision of nonbanking financial institutions to CBR; and

employees, which have banks' inspections experience.

CBR also hired staff from different financial market's segments (including Big four audit firms).

CBR continues to hire staff from financial markets.

The onsite team conducts inspections according to a methodology that has been developed by the headquarters Policy Division.

Its prime focus is the identification of breaches of the regulations, although there are checks on other matters, such as the Board discussion of the compliance officer's quarterly report (which itself is primarily about violations). According to the private sector interlocutors (but not the Inspectors themselves), the inspection team also has useful and general discussions on the overall RM system adopted by securities firms.

The inspection team conducts the inspections by reviewing internal documents and customer files—focusing on those customer files where there is some indication that the customer may be engaged in wrongdoing. The examples given by the inspection team, in discussion with the assessors, of good and bad RM practice related solely to cases where a firm had detected, or failed to detect, a suspicious transaction by a customer. The inspection team's findings (including the list of violations discovered) are reviewed by the offsite team during the inspection and, if they reveal repeated or egregious violations, a special intermediate report may be prepared (which will include evidence for immediate supervisory measures. A final report of violations together with an agreed rectification program is handed to the regulated entity on the departure of the team. The onsite inspection team is responsible for following up to check that the plan has been implemented.

Inspections were both scheduled and unscheduled. CBR did not provide data on the number of inspections of securities firms until it made its final comments on this report. According to the Annual Report of CBR, most inspections are unscheduled—which means that they are generally made in response to a suspicion of a specific breach of the regulations or a complaint. As such, they are more in the nature of investigations into breaches, rather than routine inspections. In

2014, for example, 97 inspections were scheduled and 499 were unscheduled covering the nonbank regulated financial sector—some 19,000 entities.

Scheduled inspections are based on the offsite team's knowledge of the number of complaints (from both clients and federal authorities) and breaches. The offsite team also takes into account their knowledge of the risks of the institutions and the quality of management.

There have been no inspections of exchanges.

The exchanges have automated systems that monitor market activity. The exchanges themselves monitor this information and report it to CBR. In addition, CBR has its own terminals that receive information from all nine exchanges. This information shows trading in real time and CBR can see the trading participants, including the clients of brokers. The investors are identified by codes, which allows CBR to identify the legal and natural persons who are trading. It is developing a system that can obtain and analyze information from all exchanges and identify any cross market activity. Although the system is not yet in place, CBR state that the extent of cross market activity is relatively small.

The purpose of this monitoring is to detect patterns of trading that might indicate market manipulation, insider dealing, and front running. In practice, the proven incidents of front running are relatively rare. Since 2013, there have been 70 alerts that have prompted an investigation. Of these 57 were suspected market manipulation and 13 were insider trading. Administrative penalties were imposed in 18 cases of market abuse. None of these cases have resulted in criminal penalties. The Insider Dealing Law was introduced in 2013 and the penalties were not fully available for two years after the law was enacted. CBR directed approximately 30 orders to prevent similar violations in future activity, cancelled more than 40 qualification certificates of individuals and more than 20 licenses of professional securities market participants.

CBR conducts inspections to determine if there are breaches of regulatory requirements. The sanctions imposed on professional market securities firms are as follows. In 2015, amongst professional securities firms, there were:

91 companies whose licenses were cancelled;

118 persons whose qualification certificates were cancelled (and who were thereby banned from working in the securities business for three years); and

96 administrative penalties imposed.

The focus on finding and punishing violations is also indicated by the balance between penalties and improvement notices. CBR states that in 2015 there were 96 administrative penalties imposed on professional securities firms but in only seven cases were there notices for improvement.

Article 10.1.1 of the Securities Law obliges securities firms to have internal controls and RM systems designed to avoid breaches of the regulations. In addition, FSFR Order 12-32 of May 24, 2012—the Internal Control Regulations—imposes some more detailed requirements on internal controls. However, this regulation does not include a general obligation to have adequate internal controls in place. Moreover, the detailed requirements are concerned largely with the appointment, duties and functions of a compliance officer. The report charges the compliance officer primarily with identifying compliance breaches, reporting them and dealing with them. There is no detailed requirement to have an adequate RM system or adequate policies and procedures designed to prevent breaches of the regulations.

CBR monitors the extent to which the compliance officer meets his or her obligation to identify, report on and deal with violations.

There are no provisions that enable CBR to take action against the management of securities firms for the breaches committed by staff. Article 69 of the Law on Joint Stock Companies gives responsibility to the executive body for the everyday running of the company. However, this does not give them legal responsibility for violations committed by subordinates. Article 44(10) of the Securities Law enables CBR to withdraw qualification certificates of senior officials. However, the law is quite specific that this can only be done if there are repeated violations by them (not by other staff). Moreover, the Internal Control Regulation makes the compliance officer responsible for violations, not the Chief Executive Officer (CEO) or management board.

Article 14 of the Organized Trading Law requires an exchange to set up an internal supervision program that conducts surveillance. CBR receives a daily report of all transactions on the exchange and can take steps to audit these transactions using the powers described in Principle 10 and 11.

The use of the enforcement powers

With respect to regulated persons, CBR can demonstrate that it monitors compliance with the law and regulations by regulated persons. In 2015–16, CBR has been engaged in a determined attempt to identify the professional securities firms that conducted little or no business in practice. Certain intermediaries have been placed on a watch list and have been subject to more intensive supervision, using offsite reporting, inspections and market intelligence. Some 18.7 percent have had their licenses cancelled (see Principle 29). For example, in 2015, there were 91 companies whose licenses were cancelled, 118 persons whose qualification certificates were cancelled (and who were thereby banned from working in the securities business for three years). There were 228 administrative penalties imposed.

CBR is developing its enforcement regime with respect to exchanges, described in Principles 12 and 34. There have been no onsite inspections of exchanges for some four years but such inspections are now beginning. Offsite supervision is conducted by means of quarterly reports primarily on financial information and extensive data on transactions. It is noted in Principle 37 that there is no active monitoring of short selling by the exchange. Nevertheless, CBR

	<p>undertakes its own analysis of market data and can therefore monitor the effectiveness of market surveillance by the exchanges. CBR is an active participant in the exchanges and can use its position as a member on various user committees to monitor the perceptions of other users to the effectiveness of the exchanges.</p> <p>With respect to insider dealing and market manipulation, the authorities were unable to take action until the criminal offenses were fully in force along with the appropriate penalties. The Insider Dealing Law was first enacted in 2013 and the penalties not fully available for a further year. Prior to 2013, there were no criminal offenses for market abuse.</p> <p>There has been one criminal investigation into market manipulation in the four years since the insider dealing law was enacted in 2011. There have been 70 investigations (13 on insider dealing and 57 on market manipulation). These have led to 18 cases involving administrative fines and no criminal sanctions. CBR directed approximately 30 orders to prevent similar violations in future activity, cancelled more than 40 qualification certificates of individuals and more than 20 licenses of professional securities market participants.</p>
Assessment	Not implemented
Comments	<p>The rating is given because:</p> <p>The enforcement program is not found to be fully effective;</p> <p>The planning of inspections is neither risk-based, nor routine and periodic, in that 97 scheduled inspections across the 19,000 nonbank institutions in 2014, cannot be described as routine or periodic;</p> <p>There has been no onsite inspection of the exchange;</p> <p>The supervision system for intermediaries as described by the CBR staff is primarily about finding and punishing violations, rather than looking at overall compliance and operations of the firms;</p> <p>The incidence of improvement notices is relatively rare (as compared with administrative penalties);</p> <p>the inspection resources are extremely limited, spread between the entire financial sector, and used primarily for investigating alleged regulatory breaches; and</p> <p>the offsite regime is primarily concerned with the periodic financial information together with intelligence gleaned from complaints.</p> <p>It is not possible to describe the enforcement program as fully effective. The number of onsite inspections of securities firms is limited, partly because of priority given by the inspection team to other financial businesses. The 250 staff have to conduct inspections of 19,000 nonbank financial institutions and in that context, 250 inspection staff represents an extremely limited</p>

resource. Moreover, most of the resources of the Inspection team are devoted to investigations into complaints or suspicions of breaches (499 of the inspections in 2014). Only 97 scheduled inspections of 19,000 nonbank regulated entities in the financial sector as a whole. (There was no information supplied to the assessors, during the assessment, on the number of inspections in the securities sector). CBR stated, when commenting on this report that 28 scheduled inspections (and 9 unscheduled inspections) were conducted of the securities market intermediaries in 2014 and 23 (plus 4 unscheduled) in 2015. The assessors were not able to reconcile these figures with those given in the Annual Report (28 scheduled inspections of 1,000 securities market intermediaries as compared with 97 for 19,000 nonbank financial regulated entities) both from the point of view of the total number of inspections and the ratio of scheduled and unscheduled inspections. The assessors have not been able to discuss these numbers because of their late submission but do not consider that they alter the overall assessment of this principle.

The evidence from the inspection team and the balance between scheduled and unscheduled inspections is that the focus is on finding and punishing violations rather than seeking to raise the level of RM. Even with respect to the relations with customers, the focus is on finding customers who may be engaged in fraudulent activity, rather than ensuring the intermediaries are properly protecting the customers' interests through disclosure, ethical conduct or segregation of assets. The action taken on market abuse has not extended to misrepresentation of material information or other fraudulent activity. It is not clear that there CBR is responding adequately to market intelligence (except in the case of the drive to remove intermediaries who are not conducting much business.

However, to be fully effective, the supervisory regime must move away from the focus on finding violations that was described to the assessors by both offsite and onsite supervisors.

The focus in the internal controls regulation is on the appointment, duties and functions of the compliance officer. This is not sufficient. Many of the matters that are specified in the regulation amount to the micromanagement of matters that could safely be left to the discretion of the professional securities firm (such as the procedure to be adopted when the compliance officer is away and the number of copies of a quarterly report that should be submitted to the management). A regulation on internal controls should, on the other hand, have the following elements:

An obligation on the management to undertake an assessment of the risks of the business;

A requirement to implement policies and procedures designed to mitigate those risks and maintain compliance with legal and regulatory requirements;

A duty to appoint a compliance officer to monitor the effectiveness of the policies and procedures in mitigating risks and maintaining compliance;

	<p>The obligation to appoint an internal auditor to monitor compliance with internal policies and procedures;</p> <p>A requirement that the management implement a management information system to provide information on compliance with internal controls and the effectiveness of policies and procedures;</p> <p>An obligation to provide training to staff on internal controls;</p> <p>A requirement that the management should review their risk assessment and the effectiveness of policies and procedures no less frequently than annually; and</p> <p>A duty for the management to report any material breaches of regulations to CBR.</p> <p>Moreover, it is not appropriate to place the full responsibility for ensuring compliance on the compliance officer. That responsibility should lie specifically and explicitly with the executive management of the professional securities firm. The role of the compliance officer is to support the management but the final responsibility for compliance must lie with the management. Moreover, CBR should be able to take action against the management for breaches of the regulations even where the management did not directly participate in the violation.</p> <p>CBR should support the new requirements for RM and internal controls by giving clear guidance about what a good internal control system might look like (drawing on the key points above). This need not be a detailed rule, since different firms may well need to arrange their RM in different ways. However, CBR should make it clear in its regulation that firms should implement a RM system and should adapt its inspection methodology so that inspectors were able to give a reasoned judgement on the effectiveness of that system in reducing risk.</p> <p>Although the main supervisory tools are periodic reports and onsite inspections, CBR are, quite rightly, seeking to develop the use of other techniques such as management meetings to discuss risks and to identify and disseminate good practice. This is a helpful development. CBR may wish to develop a more comprehensive program that encompasses the following:</p> <p>The issuance of guidance, public statements, interpretations of regulations and the implications of enforcement actions so as to ensure the firms understand the CBR's expectations for good RM (rather than simple compliance with detailed rules);</p> <p>Regular management meetings with regulated persons—particularly the more significant ones, at which the development of business and the implications for new risks could be discussed, along with discussion on specific compliance issues from these firms;</p> <p>Regular meetings with representatives of key stakeholders—the regulated community, SROs, the issuers, investors and auditors—at which meetings, market developments and compliance trends can be discussed, along with proposals for amendments to regulation;</p>
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	<p>Surveys of the regulated community on specific regulatory matters related to key risks;</p> <p>Requirements that regulated entities report regularly on matters that give a clear indication of their level of compliance, such as the adequacy of their risk assessments, the degree of risk scoring of customers, the development of different business lines, the number of complaints, the training of staff, the disciplinary measures taken against staff and other matters—such reports should not be confined to financial information;</p> <p>The proper division of duties between CBR and the SROs (whose supervision must also be undertaken by CBR as noted in principle 9); and</p> <p>The appropriate use of themed, targeted and full scope inspections.</p> <p>CBR will need to co-ordinate the use of these tools with the SROs, now that front line regulatory responsibility is being passed to them.</p> <p>Recommendations</p> <p>CBR should devote sufficient resources to the Inspection team to enable it to conduct an inspection program that could be described as routine and periodic or risk-based.</p> <p>CBR should conduct an inspection of the exchanges and do so in the future on a regular basis.</p> <p>CBR should seek amendments to the Securities Law that place specific responsibility for ensuring compliance with regulatory obligations on the management of securities firms.</p> <p>CBR should redraft the regulation on internal controls so as to focus on the essential elements of an internal control system rather than the detailed provisions for the appointment and functions of the compliance officer.</p> <p>CBR should review its detailed regulations and remove such items as the number of copies a compliance officer should prepare of the report and other matters in this and other regulations that amount to micromanagement of professional securities firm.</p> <p>CBR should adopt an approach to inspections and enforcement that focuses on the risks to the objectives of securities regulation, identifies the key measures to mitigate those risks and uses all supervisory tools to ensure compliance with those regulatory requirements.</p> <p>CBR should develop the periodic reporting requirements so as to gain more information relevant to the adequacy of RM and compliance by securities firms.</p> <p>The recommendations in Principle 9 about the development of a new approach to regulation now that SROs are becoming front line regulators, is also relevant here.</p>
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	<p>The assessors would recommend to the authorities to consider in more detail, the process of commencing an investigation of insider dealing and market manipulation offenses. It is clear that CBR must begin the process of investigation, because it has general responsibility for monitoring compliance and will have to make an early decision on whether administrative penalties are appropriate. On the other hand, for criminal cases, it is essential that the Law Enforcement authorities take the lead role, because they have the expertise in conducting investigations into criminal matters and preparing cases for the Investigations Committee and the prosecution authorities. In many jurisdictions, there is a risk that the early investigations by CBR will be done in a way that may not be compatible with the conduct of an investigation into criminal offenses. Although the law enforcement authorities can conduct further investigations and interviews, it is very possible that action by the regulatory authority will have tainted the evidence if the procedure was not appropriate for a criminal investigation. The authorities are aware of the problem but the assessors were not convinced that there was a full appreciation of the difficulties in arranging matters satisfactorily in practice and would recommend the authorities to develop their procedures to avoid the risks identified.</p>
Principles for Cooperation in Regulation	
Principle 13	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	<p>Domestic information exchange</p> <p>CBR has information exchange agreements with the following domestic authorities:</p> <ul style="list-style-type: none"> • General Prosecutor's Office of the Russian Federation; • Ministry of Internal Affairs of the Russian Federation; • Federal Service for Financial Monitoring; • Federal Tax Service; and • Federal Customs Service. <p>Presidential Decree 224 mandates exchange of information between domestic agencies in order to assist in the enforcement of legal requirements</p> <p>Article 44(1) of the Securities Law imposes an obligation on CBR to protect the confidentiality of matters obtained through its supervisory program. Article 23 of the Organized Trading law has a comparable provision. Article 56 of the Investment Funds Law makes staff of CBR personally accountable for the disclosure of commercial secrets. The confidentiality provision in Article 44(1) of the Securities Law and Article 23 of the Organized Trading Law can be overridden by other federal laws including the Presidential Decree.</p> <p>Article 56 of the Investment Funds Law includes no reference to the possibility of it being overridden by other legal provisions in other laws. In any case, according to the principles of</p>

legal precedence given to the assessors by CBR, provisions in primary legislation such as that in Article 56 of the Investment Funds Law cannot be overridden by a bilateral agreement or MoU.

Article 21 of the Central Bank Law empowers CBR to provide information to “advisory and coordinating bodies” established by law, except where prevented by federal law. Clearly, the provisions of Article 44(1) of the Securities Law and Article 56 of the Investment Funds Law are legal provisions that would limit the exchange of confidential information.

Cooperation with foreign authorities

Article 51¹ of the Central Bank Law states that information can be exchanged in compliance with the IOSCO MMoU, or an international treaty, or a bilateral treaty with a foreign regulator. The information may be confidential and may include bank secrets. There is no restriction on this power and it can therefore cover all matters of investigation and enforcement, matters concerned with licensing and approvals, surveillance, market conditions, client identification, details of regulated entities, and listed companies. There is no need for any approval from a government minister or attorney. There is no requirement that would prevent the information from being passed, even if there is no domestic interest, or if the issue concerned the investigation of an offense that would not contradict the laws of the Russian Federation. CBR obtains the information using the powers in Article 76⁵ of the Central Bank Law. As noted above in Principle 12, there are sanctions available for failure to respond to such a demand (RUB 30,000 (US\$425) for individuals and RUB 700,000 (US\$10,000) for legal entities).

It is clear that the provisions in Article 51¹ of the Central Bank Law would override those in Article 44(1) of the Securities Law and Article 23 of the Organized Trading Law, since the latter has an explicit exemption for disclosures required by law. However, there is no such exemption for the provision in Article 56 of the Investment Funds Law as it mandates the protection of commercial secrets with no exceptions. CBR has stated that the normal rules of legal precedence will give priority to the Central Bank Law because it is more specific but CBR has not explained why it is appropriate to provide an explicit exemption from confidentiality provisions in the Securities Law and the Organized Trading Law but not the confidentiality provision in the Investment Funds Law. The Disclosure provisions in Article 51¹ of the Central Bank Law were enacted by the same legal act that amended Article 56 of the Investment Funds Law and so it must be assumed that the Duma was aware that it was not providing an exemption to the Article 56 confidentiality provision even though it had done so for other confidentiality provisions.

Confidential information cannot be exchanged on an unsolicited basis because CBR can only provide information on the basis of a reasoned enquiry from a foreign financial market regulator (Article 51¹).

Information and records could be exchanged sufficient to identify the person or persons beneficially owning or controlling bank accounts related to securities and derivatives transactions and brokerage accounts as well as the necessary information to reconstruct a

	<p>transaction, including bank records. This is clearly within the scope of Article 51¹ of the Central Bank Law. However, this would only be so, to the extent that such records were available in the Russian Federation. As noted above in Principle 11, there are gaps in the record keeping provisions and it is not necessarily required that professional securities firms would hold information on the persons beneficially owning and controlling securities or bank accounts relating to securities transactions.</p> <p>Article 51¹ of the Central Bank Law states that information received from a foreign authority should be kept confidential and should only be disclosed with the approval of the source authority or a court of law. However, Article 51¹ also says that CBR shall be obliged to comply with disclosure requirements in Russian legislation. It does not say what those requirements are or what is to take precedence if these two paragraphs (which are consecutive) contradict each other.</p>
Assessment	Partly Implemented
Comments	<p>The rating is given because:</p> <ul style="list-style-type: none"> • The confidentiality provision in the Investment Funds Law (Article 56) is not explicitly overridden in the other laws that enable CBR to exchange information. This is particularly significant given that Article 56 imposes a personal liability on CBR staff for unauthorized disclosure. • CBR cannot provide confidential information on an unsolicited basis. • There are limitations on the ability of CBR to provide information on those beneficially owning and controlling securities and bank accounts relating to securities transactions, because such information may not have been collected in Russia. <p>The assessors are aware that CBR has been accepted as a signatory to the IOSCO MMoU. However, the observations with respect to domestic cooperation and unsolicited assistance are not covered by the questionnaire for MMoU applicants.</p> <p>CBR has helpfully explained the principles that govern the interpretation of law when two provisions are in conflict. As in virtually all countries, the Constitution has primacy and the later law is deemed to overrule the earlier. Like other Civil Law countries, the Civil Code has a special position and the more specific law will override the more general law. In the Russian Federation, the law will also be interpreted in a way that restricts the individual liberty the least. These principles would clearly not always produce the same result in a conflict and how they might be interpreted in the case of the conflict between Article 56 of the Investment Funds Law and Article 51¹ of the Central Bank Law cannot be judged by the assessors. CBR have argued that the confidentiality provision is more specific and therefore overrides the Central Bank Law which is more general. This, it is argued, makes any explicit override unnecessary. However, they have given no basis for supposing that one of these provisions should be regarded as more specific than the other and it is certainly not self-evident. Moreover, the argument is clearly undermined by the fact that in most other cases, the laws have included an explicit provision that confidentiality requirements can be overridden by law. The absence of such a provision in the case of Article 56 must be regarded as significant, especially as the last amendment to Article 56 was enacted in the same legal act that introduced the disclosure provisions in Article 51¹ by amending the Central Bank Law.</p>

	<p>The matters identified above would result in a “Not Implemented” rating. However, for the most part, the provisions in the Securities Law, the Organized Trading Law, the investment Funds Law, the Clearing Law, and the Central Bank Law are such as to enable CBR to exchange information domestically and with foreign agencies. The limitations described above a partial at most.</p> <p>Nevertheless, it is important that these matters be resolved.</p> <p>Recommendations</p> <p>CBR should seek an amendment to the Central Bank Law to enable it to provide confidential information to a foreign regulator on an unsolicited basis.</p> <p>CBR should seek an amendment to the Investment Funds Law that provides an exception to the commercial secrets provision where disclosure is permitted by law.</p> <p>The recommendations with regard to record keeping in the Enforcement Principles would also address the other issues raised above.</p>
Principle 14	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	<p>The legal power of CBR to share information with domestic agencies is given in Article 21 of the Central Bank Law and is demonstrated by the existence of agreements with:</p> <ul style="list-style-type: none"> • Federal State Statistics Service; • Russian Federation Ministry of Internal Affairs; • Federal Financial Monitoring Service; • Federal Tax Service; • Deposit Insurance Agency State Corporation; • Russian Federation Prosecutor General; • Russian Federation Federal Security Service; • Russian Federation Federal Drug Control Service; • Federal Customs Service; • Russian Federation Investigative Committee; and • Federal Financial and Fiscal Supervision Service. <p>CBR is entering into legal agreements with:</p> <ul style="list-style-type: none"> • the Federal Financial Monitoring Service; • the Federal Tax Service; and

	<ul style="list-style-type: none"> the Russian Federation Ministry of Internal Affairs. <p>The ability of CBR to enter into legal agreements with foreign authorities is confirmed by Article 51¹ of the Central Bank Law. CBR is a signatory to the IOSCO MMoU and can therefore clearly enter into such agreements. It has also signed agreements with regulatory authorities in Cyprus, Lao, and Belarus.</p> <p>In practice, CBR was able to respond to 26 of 30 requests for information from foreign authorities in 2015. Of the total 30 requests, 16 were received under the MMoU. The four that could not be completed were because of insufficient information to identify the person who was the subject of the enquiry. The requests were met within 1.5 to 2 months with the exception of two requests, which CBR had to request information (answers took about six months).</p> <p>Article 51¹ of the Central Bank Law requires the protection of the confidentiality of information received.</p>
Assessment	Fully Implemented
Principle 15	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>CBR has the power to exchange information (including confidential information) with foreign regulators where they are signatories to the MMoU or to a bilateral agreement or treaty (Article 51¹ of the Central Bank Law). The power to collect information (described in the enforcement principles) in the Central Bank Law, the Securities Law, the Investment Funds Law, the Organized Trading Law, and the Clearing Law would encompass all relevant categories of information except, as noted in the description of the Enforcement Principles.</p> <p>The following points, noted in the descriptions of Enforcement and in Principle 13 could also affect the assistance to be given in practice:</p> <ul style="list-style-type: none"> Article 51¹ of the Central Bank Law conflicts with Article 56 of the Investment Funds Law where no exemptions are permitted to the prohibition on disclosure of commercial secrets; and The provisions requiring the collection of beneficial ownership have limitations that mean that certain transactions may take place where the beneficial owner is not known. <p>The power to exchange information on the matters listed in this principle does not depend on there being any domestic interest. There is no need for the approval of a government minister or attorney (Article 51¹ of the Central Bank Law). The powers to exchange information, given in Article 51¹ of the Central Bank Law and the powers to collect information described above include documents and explanations (and thus includes oral statements) and there is a penalty for failing to provide information. There is no limitation on the information that can be</p>

	<p>collected and exchanged and it therefore will include the information necessary to reconstruct a transaction including bank records. Beneficial ownership information can be exchanged where it is located in the jurisdiction.</p> <p>The description of the enforcement principles also shows that CBR is permitted to obtain court orders.</p> <p>Article 44(7) of the Securities Law also empowers CBR to collect information from issuers that is relevant to this principle.</p> <p>There is no limit in Article 51¹ of the Central Bank Law on the uses to which the information can be put by the recipient.</p> <p>In practice, CBR was able to respond to 26 of 30 requests for information from foreign authorities in 2015. Of the total 30 requests, 16 were received under the MMoU. The four that could not be completed were because of insufficient information to identify the person who was the subject of the enquiry. The requests were met within 1.5 to 2 months.</p>
Assessment	Fully Implemented
Comments	<p>This rating is given on the basis that the absence of any exemption in Article 56 of the Investment Fund Law to allow disclosure when mandated by other laws has not, in practice, inhibited the ability of CBR to provide assistance to foreign regulatory authorities. Moreover, the rating assumes that the gaps in the legislation identified in the description have not inhibited the exchange information in practice.</p>
Principles for Issuers	
Principle 16	There should be full, timely and accurate disclosure of financial results, risk and other information that is material to investors' decisions.
Description	<p>The nature of companies in the Russian Federation is in transition. The legal provisions are complex and are contained in the Civil Code, Chapter IV, Law 208 of December 26, 1995 on Joint Stock Company Law and Law 39 of April 22, 1996 on Securities (the Securities Law). These were:</p> <ul style="list-style-type: none"> (1) closed joint stock companies that could not offer shares to the public; and (2) open companies that could offer shares to the public. <p>Some open companies had made public offers of equities and, of these, some were listed on an exchange. These companies had issued a prospectus.</p> <p>Some open and closed companies had issued bonds which were listed on an exchange. These companies had also issued a prospectus.</p>

Companies that issue a prospectus are subject to additional disclosure requirements, including the requirement to issue quarterly as well as annual reports.

Changes to the Civil Code in 2014 have simplified the position, so that, in the future, there will only be public companies, whose shares are listed on an exchange, and private companies.

During the transition, existing companies will have to amend their charters to become either public or private companies and, if public, must be listed on an exchange. All new companies will either have to be private companies, or public companies listed on an exchange.

Existing public companies that have issued a prospectus prior to July 1, 2015, have five years to amend their constitution so that they are either private or listed. CBR estimates that in 2016, there are approximately 4,000 public companies that have issued a prospectus (but are **not** listed on an exchange) and a further 400 that have issued a prospectus and **are** listed on an exchange. Most of the 4,000 do not, in practice, have widely held shares. The large majority of these will probably cease to be public companies and will be private companies.

Companies that are currently public (including those who have issued prospectuses) and wish to become private companies can do so if certain conditions apply, particularly that 95 percent of shareholders in all categories agree (Article 7.2 of the Joint Stock Company Law). This threshold applies to shareholders not voting rights. Those who did not vote or voted against are entitled to have their shares repurchased at a price determined by the directors but no less than the average price over the previous six months, where this price is determined by organized trading. There is no provision for the price to be determined by companies whose securities are not traded on an organized exchange (Article 75 of the Joint Stock Company Law).

Companies that wish to become listed must meet the listing requirements of an exchange.

There is no provision for companies that fail, by the end of the transition period, to meet the conditions to become private, or meet the listing conditions of an exchange.

This description below will describe only the disclosure requirements that apply to companies that have issued a prospectus, which for the purposes of this description will be called public companies. For the purposes of Principle 18 (Accounting standards) the difference between the public/non-listed and the public/listed (which will continue to exist during the transition) will continue to be important because of the different requirements as regards IFRS. For Principle 16, the disclosure requirements that apply to all companies that issue a prospectus are described below.

Article 22(1) of the Securities Law states that all companies that offer securities to the public must publish a prospectus, except where:

- They are placed with (any number of) qualified investors and no more than 500 existing shareholders, no more than 500 investors with pre-emptive rights and no more than 150 other (non-qualified) investors;
- The offer is available only to a closed group of no more than 500 investors (excluding qualified investors);
- The offer does not raise more than RUB 200 million (US\$2.7 million), or in the case of a bond offer by a credit institution no more than RUB 4 billion (US\$54 million); and
- There is a minimum subscription of RUB 4 million (US\$ 57,000) except for those with pre-emptive rights, provided there are no more than 500 such investors.

An offer solely to qualified investors does not result in a company being obliged to issue a prospectus. Qualified investors are defined in Article 51.2 of the Securities Law. They are financial institutions (banks, insurance, securities intermediaries, etc.), pension and other funds, certain public and international agencies, including CBR and the IMF, and some individuals defined in the Securities Law and regulations. Essentially, these are individuals with professional experience in the securities market, substantial trading experience or high net worth and the capacity to make large investments.

Article 22(2) of the Securities Law states that a prospectus must include three years audited accounts and the latest (unaudited) interim accounts for the last three, six or nine-month period (if such a period has passed since the publication of the last audited accounts). Moreover, Article 24.1 of the Securities Law obliges an issuer to publish an amended prospectus if the accounts are affected by a major event, between the registration of the prospectus and the placement of the securities.

Article 22 of the Securities law obliges an issuer to disclose:

- Information about the issuer and the securities being offered;
- Information about the issuer's economic and business activities;
- Accounting and financial data, including audited financial statements (as above);
- Consolidated financial statements if the issuer is part of a group;
- Details of the securities being offered; and
- Details of any person providing security for a bond issue (in the case of a bond issue).

In addition, Article 22(3) also creates a general obligation to include in the prospectus all circumstances that may have a material impact on a decision to buy the securities.

Detailed requirements for the content of prospectuses are included in Annex to Regulation 454-P of December 30, 2104 on disclosure by issuers (The Disclosure Regulation). These include the full range of disclosures expected by IOSCO for a prospectus.

Article 22 also requires a company to issue a supplementary prospectus if there are changes that may have a material impact on a decision to buy the securities.

The prospectus must be registered with CBR. CBR reviews the prospectus to ensure that it complies with the law and regulations and will only register it if it is in compliance. The requirements for its distribution are covered by the general provision in Article 30(1) that states that disclosure means making the document accessible to anyone without restrictions. Further detail is given in the Disclosure Regulations.

Article 92 of the Joint Stock Company Law obliges a company to publish an annual report, whose disclosures are covered in the Joint Stock Company Disclosure Regulations. This report must include information on the company's position in the industry, the main lines of business, the directors' report on activities, energy resources used and prospects. It must include details of dividends. There must be a list of the basic risk factors relating to the activities of the company. There should be information on large and related party transactions. The report should give information on the board of directors, including any changes. The report should show the shares and other securities held by the directors and any purchases and sales by them. There should be details of the CEO and other management officers. Information should be given on remuneration.

The annual report of a public listed company should show the degree of compliance with the Corporate Governance Code and more general details of corporate governance.

In addition, companies that issue a prospectus are obliged to issue quarterly as well as annual reports (Article 30(4) of the Securities Law.). Article 30(12) obliges an issuer to publish its audited annual consolidated financial statement no later than 120 days after the end of the accounting year and the interim financial statements, no later than 60 days after the end of the second quarter. All quarterly reports should include consolidated financial statements.

Article 4(1) of the Law 46-FZ of March 5, 1999 on investor protection (the Investor Protection Law) prohibits the publication of any advertisement to an unlimited number of people, unless it follows the legislative provisions for new issues (which would be the prospectus). This effectively prohibits any advertisement relating to public offers except for the prospectus itself. However, advertisements for public offers are allowed in practice once a prospectus has been published, despite the prohibition in the Investor Protection Law. The only relevant provisions regarding advertisements are Article 5 and Article 28 of Law 38-FZ of March 13, 2006 on advertising (the Advertising Law). These are general provisions that prohibit inaccurate or unfair advertisements, prohibit the omission of relevant material information, prohibit guarantees and require a risk warning to be included, along with the name of the person issuing the advertisement. There is no requirement that such advertisements should be approved in advance by CBR.

The disclosure requirements also cover the convening of a general shareholders' meeting (Article 92(1) of the Joint Stock Company Law). In addition, Article 52(3) of the Joint Stock

	<p>Company Law obliges companies, when giving a minimum 20-day notice of a general meeting to inform shareholders where they can obtain certain information, including the annual report, financial statements and audit report, information on candidates for election, and other information. The information, which must be made available at premises stated by the company and its website can be copied and sent to the shareholder at the shareholder's expense if they wish. The information must be made available at least 20 days before the meeting (70 days for an emergency general meeting).</p> <p>After the securities have been issued, companies must also disclose material facts. Article 30(14) and paragraph 12.7 of the Disclosure Regulation give a list of 50 examples of matters that should be regarded as material facts—and therefore must be disclosed. The list includes various corporate matters involving the rights attached to securities and various corporate actions including takeovers and offers. Litigation is included, as are errors or omissions in the company's compliance with disclosure and other regulations. However, the list excludes many of the most common events that are likely to affect the price of a company's securities such as a material change in prospects, a change in risks, a change in the economic circumstances of the country or region in which the issuer does most of its business, the signing of a major new contract, the loss of a major contract, a major physical or weather event that affects the continued operation of the company, a significant change in the line of business, a decision to acquire or sell significant assets or any other major event which is likely to affect the value of the company's assets or its ability to continue to make profits.</p> <p>Of these 50 items, the last is "any other fact which, in the issuer's opinion significantly influences the value of securities." This is consistent with Article 30(4) which states that any material event must be disclosed. Material events must be disclosed in quarterly reports as well as at any time, within one day for a news feed and two days for a website (paragraph 13.1 of the Disclosure Regulations).</p> <p>This general obligation may also be provided by Article 30(4) of the Securities Law, which lists reports on material facts as one of the forms in which disclosures may be made.</p> <p>However, in practice, both CBR and industry participants say that is very rare for any disclosures to be made under this heading. CBR state that, in 2015, of a total of 243,000 "material fact" disclosures, 2,814 were in the "any other event" category. CBR observed that in order to impose a sanction, it would be necessary to prove the event and that it did or could have affected the price of a security. In practice, this meant that it would be very difficult to impose sanctions against a company that failed to disclose something in this "any other event" category. The private sector confirmed that it was not regarded as a real obligation.</p> <p>It is not hard to identify possible disclosures that are not identified in the 50 listed disclosures. For example, although companies are required to disclose prospects in prospectuses and quarterly reports, it is very rare, if not unknown, for any company to issue a profit warning. The requirement to disclose a significant deterioration in profit expectations is not included amongst the 50 items and yet it is clear that such a deterioration would affect the price of the</p>
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securities. In practice, the inclusion of a provision to disclose “any other matter...” does not amount to a real obligation to disclose any material matter that could affect the decision to buy or sell the securities.

Article 92(1) of the Joint Stock Company Law and Article 30.1 of the Securities Law give the company the right to seek relief from the duty of disclosure from CBR. This provision is designed for public companies that have fewer than 500 shareholders and are not listed. CBR will give such a waiver only if the relevant criteria are satisfied, which include the agreement of 95 percent of shareholders (this applies to shareholders not voting rights, according to Article 92.1 of the Joint Stock Company Law), the absence of any significant trading in or widespread holding of securities.

Article 22.1(3) of the Securities Law and paragraphs 8.5–8.7 of the Disclosure Regulations state that those signing the prospectus (the board, chief accountant, appraiser and if required, financial consultant, and legal consultant) must confirm the reliability of the information. They, together with those who voted for the prospectus and the audit firm shall jointly and severally bear vicarious liability for damages as a result of unreliable or incomplete information. Articles 185 et seq of the Criminal Code create a criminal liability for failures to disclose information, although no criminal penalties have been imposed for failures in respect of a prospectus. Other violations of the disclosure provisions, however, have resulted in criminal penalties.

Prospectuses are submitted to CBR for review, and, if approved, registration. Article 21 of the Securities Law gives CBR the right to refuse to register securities if the documentation does not demonstrate compliance with the law. This would enable CBR to refuse to register a security unless it met the requirements. After the registration of a prospectus, Article 26 permits the suspension of an issue by CBR under certain circumstances that include the discovery that certain information is unreliable (Article 26(1)(2)). CBR say that this provision allows them to insist on changes to a prospectus and that they do, in practice, take such action from time to time, particularly when the prospectus fails to meet the statutory requirements. Article 26 also allows CBR to go to court to declare an issue invalid.

It is clear from paragraph 2.13 of the Disclosure Regulations that, although there is no explicit provision that exempts companies from making disclosures where there are state or trade secrets, it is accepted in practice that there are some unspecified exemptions from disclosure. This matter is left to the discretion of the issuer. If CBR considers that the omission of material information has not been done for good reason, they may impose an administrative penalty of between RUB 700,000 and RUB 1 million (US\$10,000–US\$14,000). There are otherwise no specific provisions implementing safeguards in such circumstances apart from the general provisions on insider dealing (Article 6 of the Insider Dealing Law). There are sanctions for breaching the Insider Dealing Law (see Principles 10–12).

CBR takes action to monitor the disclosure obligations of issuers. The Exchange confirmed that it does not, in practice separately monitor the disclosure obligations of companies, although CBR state that it has an obligation to do so. The table below gives an indication of the number

	<p>of complaints prescriptive orders and sanctions. CBR states that typical violations relate to failure to file reports on time.</p> <table border="1" data-bbox="532 342 1255 506"> <thead> <tr> <th></th> <th>2014</th> <th>2015</th> </tr> </thead> <tbody> <tr> <td>Complaints</td> <td>422</td> <td>405</td> </tr> <tr> <td>Prescriptions</td> <td>924</td> <td>1,683</td> </tr> <tr> <td>Administrative sanctions</td> <td>274</td> <td>360</td> </tr> </tbody> </table> <p>Public offers or listings from foreign issuers are not significant in th Russian Federation.</p>		2014	2015	Complaints	422	405	Prescriptions	924	1,683	Administrative sanctions	274	360
	2014	2015											
Complaints	422	405											
Prescriptions	924	1,683											
Administrative sanctions	274	360											
Assessment	Not Implemented												
Comments	<p>This rating is given because:</p> <ul style="list-style-type: none"> • There is no effective ongoing general obligation to disclose any material fact that may affect a decision as to whether or not to buy or sell securities (apart from those items listed in Article 30(14) of the Securities Law and the Disclosure Regulations, which exclude critical disclosures such as changes in prospects or risks); • There are no proper provisions enabling a derogation from the disclosure provisions for state or commercial secrets and no safeguards to apply when such a decision to withhold information is made, even though it is clear that companies do withhold information on these grounds; • There is no specific power to require a company to make a disclosure (unless CBR discovers, after the event, that a disclosure has not been made); • There is no provision relating specifically to advertisements in relation to public issues, except for that in the Investor Protection Law, which appears to be ignored in that advertisements are published outside the prospectus, even though prohibited by the Investor Protection Law). • In each case, there are provisions in place but they are not sufficient, in formulation or implementation to meet the requirements of the principle. • There is a general requirement to disclose any material matter that might affect the price of securities. CBR say that it is difficult to enforce any failure to disclose a matter unless it is one of the 50 specific items listed in the law. These specific matters include routine events like general meetings which would not affect the price of securities but do not include significant events such as a material change in prospects or risks. Although such matters could be covered by the general continuing obligation, CBR state that only just over 1 percent of disclosures fall into this category and the industry say that it is ignored. Profit warnings, for example, are rare. • There is no explicit derogation from disclosure obligations for state and commercial secrets in the law and so, strictly speaking, disclosure of such secrets is required. 												

	<p>However, CBR state that this prohibition is not enforced and that in practice, such secrets are not disclosed. Indeed, the regulations envisage that such secrets will not be disclosed (despite the absence of any provision for a derogation in the primary law). There are no provisions to safeguard the investor or the market from the failure to disclose. Such safeguards should normally include giving CBR the power to require advance notice of any decision to delay disclosures of material facts for these reasons, and to give or deny approval to such a delay, depending on the nature of the information. CBR should also be able to insist on disclosure within a reasonable timetable and to take action (including suspension of trading) if it considers that this is necessary to protect the market.</p> <ul style="list-style-type: none"> • CBR state that advertisements are prohibited before the prospectus and that after that advertisements are covered by the Advertising Law. However, in fact, the Investor Protection Law bans all advertisements other than the prospectus itself and does not permit advertisements relating to a public offer, even after a prospectus is published. CBR do not enforce this provision and instead allow advertisements to be published after the prospectus is published. The provisions of the Advertising Law are very general and do not contain the provisions necessary to ensure that advertisements published outside the prospectus are appropriate. It is not appropriate for CBR to allow such advertisements to be issued in a way that may be breaching the Investor Protection Law. • The disclosure requirements are distributed between the Joint Stock Company Law, the Securities Law, the Disclosure Regulations and the annexes to the Disclosure Regulations. Some of these provisions have only recently come into effect and some of them are subject to repeated amendment. In the case of some of the requirements, one law must be read in the light of another. In other cases, there is duplication of the same requirements (such as many of the items in the list of material facts). It is important for the proper regulation of the securities market that the legal and regulatory requirements should be clear. This degree of complication, duplication and overlap make it difficult for users of the capital market to establish what the law is and thereby increase costs. • The continuing existence of practices not directly permitted by law (such as the omission of material facts where they are state or commercial secrets and the publication of advertisements outside the prospectus) are particularly inappropriate since they undermine respect for the law. • It is commendable that CBR takes action to impose penalties on companies that fail to disclose information. • The proposals to simplify the current provisions regarding public and non-public companies is welcome. However, the current arrangements do not provide specifically for companies that are currently public and which fail to meet the conditions to
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	<p>become private or to gain a listing on an exchange. It will be necessary to make provision for this before the end of the transition period.</p> <p>Recommendations</p> <ul style="list-style-type: none"> • The Securities Law should include a provision that requires the disclosure of any material fact that would reasonably be expected to affect the price of a security and the decision to buy or sell that security both at issue and at any time thereafter. Such a provision should be the overriding disclosure provision in the Securities Law. • The 50 detailed matters for disclosure should be removed from the Securities Law and left in the Disclosure Regulations (which is the appropriate place for such detail) and reinforces the primacy of the overriding obligation to disclose all material facts. • The 50 detailed matters listed in the Disclosure Regulation should exclude routine events which would not affect the price of a security (such as the announcement of a general meeting) and include a material change in prospects, a significant change in risks, a change in the economic circumstances of the country or region in which the issuer does most of its business, a significant change in the trading environment, the signing of a major new contract, the loss of a major contract, a major physical or weather event that affects the continued operation of the company, a significant change in the line of business, a decision to acquire or sell significant assets or any other major event which is likely to affect the value of the company's assets or its ability to continue to make profits. • The Securities Law should be amended to specify what derogations from disclosure might be acceptable, a procedure for providing approval and safeguards to be considered (such as suspension of trading) for dealing with the consequences for investors. • The Investor Protection Law and the Law on Advertising should deal more comprehensively with the advertisements so as to ensure that advertisements issued in connection with a public offer, should be issued only by the issuer or advisers acting under the issuer's authority, should only contain information that is true and not misleading, should refer to the prospectus and should be subject to approval by CBR. • The law should give CBR specific powers to require issuers to make disclosures when material events have occurred (or CBR discovers that they may be about to occur) but the issuer has failed to meet its disclosure obligation. • CBR should consult the private sector with a view to simplifying the structure of the legal and regulatory framework for disclosure, so as to achieve a more easily understood (and hence enforceable) regime.
Principle 17	Holders of securities in a company should be treated in a fair and equitable manner.
	Registration and voting

The first right of a shareholder is to have ownership of securities registered and given legal effect. This is provided for in Article 44 of the Law 208 of December 26, 1995 on Joint Stock Companies. The right to sell shares (without the permission of other shareholders) is given in Article 2(1).

Article 49(1) of the Joint Stock Company Law gives the shareholders the right to vote at general meetings. Article 59 provides that one share carries one vote. Article 52 states that the agenda shall be sent out in advance and makes clear that such meetings include the election of directors and requires voting on changes to the constitution of the company (which includes changes to corporate structure and the terms and conditions of securities). Moreover, Article 48(1) shows the formation of the executive, the type and face value of shares and corporate changes to the constitution as being matters to be determined at the general meeting of shareholders. Article 49 states that the decision to pay a dividend is taken by a general meeting of shareholders and Article 42 provides that a dividend, when payable must be paid equally to all shareholders of a particular class.

Article 52 of the Joint Stock Company Law prescribes a list of documents that should be provided to shareholders and this is expanded in Regulations (FFMS Regulation 12–6/pz of February 2, 2012—the General Meeting regulation). The information includes the reason for a company reorganization and information to comprehend the position of the company. The Corporate Governance Code also has provisions that encourage companies to create favorable conditions for shareholders' participation in meetings. This would include the position of directors for and against proposals at the meetings. However, there is no general provision that obliges a company to provide shareholders with all the information they require to be able to make an informed opinion on the matters before them at a general or emergency meeting.

Article 53 gives holders of more than 2 percent of the voting shares the right to put items on an agenda (unless they are out of scope).

Article 52(1) of the Joint Stock Company Law also obliges companies to give 20 days' notice of shareholder meetings. Article 52 also provides for a 70-day notice period for an extraordinary meeting where this considers the election of directors or corporate changes such as a merger.

There is no express provision for proxies but a shareholder may appoint a representative to act for them at a general meeting by granting a power of Attorney in accordance with the Civil Code or having a notary certify the appointment (Article 57(1) of the Joint Stock Company Law). Legislation which came into effect in 2014 allows shareholders with nominee accounts at the central depository to vote electronically at General Meetings, without being present. New legislation that comes into effect in July 2016 will give the right to vote to those who hold beneficial ownership of shares but hold them in the name of custodians or others.

Holding directors to account

Shareholders can hold directors to account at general meetings where there must be elections. The shareholders may also take directors to court if there is a violation of the Joint Stock Company Law (Article 68(6)). Under Article 53 of the Civil Code directors are obliged to act in good faith and, under Article 53.1 can be held liable for any losses as a result of a failure to act in good faith. Article 71(1) of the Joint Stock Company Law also imposes an obligation on directors to operate in the interests of the company and shall be liable to the company for any losses arising from their failure to do so (unless there are other grounds stated in other laws for liabilities to be imposed by others).

Minority shareholders

Minority shareholder can go to court if those holding 1 percent of the voting right consider that their interests have not been properly protected by the directors and that there has been a legal violation (Article 71 of the Joint Stock Company Law). CBR say that this right has been exercised in practice. There are provisions that permit shareholders of a particular category of share to demand redemption of their shares if there are changes to their terms and conditions against which they voted (Article 75(1) of the Joint Stock Company Law).

Insolvency

Article 21 of the Joint Stock Company Law provides for agreement by shareholders for voluntary liquidation. Article 23 of the Joint Stock Company Law deals with the distribution of property of a company under liquidation and this provides a set of priorities for distribution. This includes a priority for dividends credited but not paid and then the distribution of assets to holders of common stock, which must be undertaken according to the charter of the company (which will identify preferred and common stock). The law does not explicitly state that any remaining assets after completion of the liquidation shall be distributed in accordance with shareholdings (except in the case of dividends credited but not paid—Article 23).

The insolvency of companies is covered by the Law 127 of October 26, 2002 on Insolvency and contains the provisions necessary to deal with orderly bankruptcy. The law provides for the shareholders to be informed about a pending bankruptcy and to take action to avoid bankruptcy if possible (Article 30). An application for bankruptcy must be sent to the shareholders' representative (Article 37). The law gives a representative of shareholders the right to attend but not vote at creditors' committees (Article 12). The shareholders are to be informed of a meeting to consider financial rehabilitation (Articles 64 and 76) and subsequent meetings to consider aspects of the insolvency (for example, the institution of receivership, Article 68). The shareholders have the right to dispute the claims of creditors (Article 100). The shareholders have the right to seek compensation against the management of the company for

the losses arising from bankruptcy (Article 10). Representatives of shareholders have the right to receive information from the receiver (Article 12).

Takeovers

The Joint Stock Company Law also makes provision for takeovers in Chapter XI and the relevant regulations.

Articles 84.1 and 84.2 of the Joint Stock Company Law deal with voluntary or mandatory offers. A person who intends to acquire (alone or in concert with affiliated persons) more than 30 percent of the shares may make a voluntary offer. A person who has already (alone or in concert with affiliated persons) acquired more than 30 percent, 50 percent or 75 percent is obliged to make an offer. The minimum price must be the weighted average of prices over the previous six months (unless the offeror has acquired securities at a higher price in the previous six months, in which case, the higher price will apply). The price offered must be uniform for all shareholders of a particular class.

The Joint Stock Company Law makes clear (for example in Article 84.2) that the requirements relating to a person acting in concert with others, only apply where the shareholder and the others with whom it is acting in concert are affiliated persons. Article 93 of the Joint Stock Company Law states that a person shall be deemed to be affiliated in accordance with the requirements of Russian legislation and gives two references:

- Presidential Decree 1186 of October 7, 1992 (on investment funds); and
- Order of the State Management Committee No 723 of April 5, 1994.

However, on enquiry, CBR states that neither of these references are relevant in this context and, in fact the relevant definition on affiliated persons is set by Article 4 of Law 948-I of March 22, 1991 on Competition and Law 135-FZ of 26 July 2006 on Competition Protection. Neither of these have been provided to the assessors but, according to CBR, they restrict the definition of an affiliated person of a legal entity to directors and entities in the same group or those with shareholdings of more than 20 percent, or in other cases, business entities with in which the same individual has more than 50 percent of the total voting power. The precise definitions appear somewhat complex but it is clear that the provisions relating to those acting in concert are restricted to an affiliated person (however defined) and would not include those acting in concert with individuals or entities who were not affiliated according to this provision.

The board must assess the bid and make a recommendation within 15 days that includes their assessment of the effect of the bid on the value of shares as well as an assessment of the plans of the person making the bid (Article 84.3). Article 84.1 stipulates that the offeror must give information on the bid to the company and the company must provide that information to the shareholders. The offeror also has the right to provide information on the bid to the shareholders. Articles 84.1 and 84.2 also sets out the timetable for considering a bid and provides for a minimum of 70 days and a maximum of 80, or 90 days (for mandatory and

	<p>voluntary offers respectively) for the shareholders to consider the offer (Articles 84.1(2), 84.2(2)). All shareholders must receive details of the offer and the assessment (Article 84.1(1 and 2), 84.2(1 and 2) and Article 84.3). They must all be able to accept the offer if they wish and receive the offer in cash if they wish (Article 84.1(2) and 84.2(5)).</p> <p>Once an offer has been made, any revised offer must be available to all securities holders (Article 84.2(4)). Article 84.7 includes the right of shareholders to demand the offeror acquires more than 95 percent of the shares. Article 84.8 includes the “squeeze out” provision that enables an offeror to acquire all remaining shares once the offeror has acquired more than 95 percent of the shares. In such cases, the remaining shareholders may also insist on their shares being bought at the offer price.</p> <p>Disclosure of shareholdings</p> <p>Article 30(14)(25) of the Securities Law requires disclosures to be made when a person (acting alone or in concert with affiliated persons) acquires 5 percent, 10 percent, 15 percent, 20 percent, 25 percent, 30 percent, 50 percent, 75 percent or 95 percent of the voting rights. The persons who acquire the shareholdings are obliged to inform the issuer according to Article 30(23 of the Securities Law). This must be done within 10 days, according to paragraph 2.2 and 2.3 of the Disclosure Regulation. Paragraph 13.1 of the Disclosure Regulation states that a material fact (of which the passing of an ownership threshold is one) shall be disclosed within one day on a news feed and two days on the issuer’s website. These major shareholdings must also be disclosed in the annual and quarterly reports according to the Disclosure Regulations.</p> <p>Paragraph 70.3 of the Disclosure Regulation states that any transactions in shares by directors during the accounting year shall be disclosed in the annual report. Article 30(14(40) states such matters to be a material fact and therefore should also be disclosed immediately. The Annex to the Disclosure Regulations states that the shareholdings of directors should be disclosed in the prospectus (paragraph 5.2 of Section V). Paragraph 5.2 of Annex 3 of the Disclosure Regulations requires this information to be disclosed in the quarterly report. This requirement extends to the executive body of the issue and thus includes senior managers.</p> <p>CBR undertakes enforcement activity to protect shareholder rights. It states that typical violations are violations related to GSM convocation and holding, breach of Chapter 11.1 of the Joint Stock Company Law (mandatory bids and buy-outs), related party transaction approval, dividends payment, provision of certain documents at the shareholder request.</p> <p>Public offers by foreign companies are not significant in the Russian Federation.</p>
Assessment	Partly Implemented

Comments	<p>The rating is given because the provisions relating to the thresholds for disclosure of substantial shareholdings or requiring a mandatory takeover offer only apply to those acting in concert with affiliated persons and not those acting in concert with any person.</p> <p>Although there is no general requirement to provide sufficient information to enable shareholders to make an informed decision, the information that is specified is considered by the assessors to be sufficient to meet the terms of this principle.</p> <p>The assessors are also bound to observe that the legislative requirements relating to the “acting in concert” provisions are obscure and difficult to interpret. The Joint Stock Company Law refers to “affiliated persons” and states that a definition is given in Russian legislation. This does not help a person seeking to comply with the law—especially as CBR states that the specific legislative references given in the notes to the law are not relevant in this context and that the actual definition of an affiliated person can be found in two competition laws enacted in 1991 and 2006.</p> <p>The disclosure of significant shareholdings takes place in a two step process, whereby the acquirer of a significant shareholding must inform the issuer within 10 days and the issuer must make a public announcement within one or two days. CBR may wish to consider making a requirement that the disclosure of such shareholdings should be made immediately by the acquirer—where the issuer is a listed company.</p> <p>CBR is recommended:</p> <ul style="list-style-type: none"> • To amend the provisions in the Joint Stock Company Law so that the requirements relating to disclosures and takeover offers apply to those acting in concert with any person and not just those that meet the definition of affiliated persons. • To extend the requirements for information to be provided for general meetings so as to include full information on the reasons for proposals put to meetings and the consequences of decisions proposed on the agenda. • To state explicitly the rights of shareholders to receive remaining assets after liquidation, in proportion to the shareholdings (in relation to all assets and not just in respect of dividends credited but not paid).
Principle 18	Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.
Assessment	<p>Article 22(2) of the Securities Law requires a prospectus to include audited financial statements—both individual for the issuer and consolidated for the group of which it is a part. Article 30(6) states that there should be quarterly reports and that the first quarter report should include the audited consolidated financial statements for the last complete accounting year. Interim consolidated financial statements for a six-month period shall be published no later than 60 days after the end of the period to which they relate. There are also requirements for quarterly financial statements (not necessarily consolidated) covering three,</p>

six and nine month periods. These provisions apply to all public companies whose shares are offered to and held by the public (see Principle 16).

The Russian Federation is moving to full compliance with IFRS by companies whose shares are offered for public subscription. However, at the time of the assessment, not all companies were subject to this requirement. Moreover, many of those that were, met the requirement in a formal sense, while still using RAS as the primary means of disclosure. The current position is somewhat complex and is described below.

Law 208 of July 27, 2010 on financial reporting (the Financial Reporting Law) applies to a specified range of companies that include banks, insurance companies, non-government pension funds, investment fund management companies, clearing organizations, some other companies with a degree of government ownership or control, and all listed companies. It states that they must publish consolidated financial statements according to IFRS. It does not apply to those companies that have made a public offer but whose shares are not listed. However,

Articles 22 and 30(4) of the Securities Law state that companies whose shares are offered for public subscription (with the exemptions described in the description of Principle 16) must disclose financial information in the form of consolidated financial statements, where they are members of a group; and

Article 3 of the Financial Reporting Law states that consolidated financial reporting standards shall be drawn up in accordance with IFRS.

As a result, all companies that are not listed but are members of a group of companies must prepare consolidated financial statements in accordance with IFRS. This leaves only companies that have offered shares to the public but are neither listed, nor members of a group that are not yet subject to a requirement to publish accounts in IFRS.

According to CBR, most public companies fall into this last category, although only a few of them have widely distributed shares and (as noted in Principle 16) they are subject to a set of transitional provisions that will require them to choose between becoming listed companies or going private by 2019.

Moreover, there is a schedule for bringing all remaining companies into IFRS as follows:

Certain insurance companies and companies with listed bonds had to submit accounts according to IFRS as from the reporting year 2012; and

State pension funds, investment fund management companies, non-government pension funds and clearing organizations are required to adopt IFRS beginning with the reports for 2015 (according to Instruction 3374-U of September 1, 2014).

In summary:

All companies that are listed and most companies whose shares are held by more than a narrow group are already subject to a requirement to publish financial statements in IFRS;

Those that are not yet subject to such a requirement, will be required to do so according to a schedule that will bring them all into IFRS by 2019;

Many companies whose shares have been formerly offered to the public but which are not widely held, will be required to choose becoming listed or going private by 2019; and

Thus, by 2019, all companies whose shares are widely held will be required to publish financial statements in IFRS and all other companies will be private by 2019.

Article 22(2) of the Securities Law obliges companies that issue a prospectus to include audited financial statements in the prospectus. Articles 30(6) and (12) requires companies to publish audited financial statements in the first quarterly report following the publication of the financial statements and audited consolidated IFRS financial statements no more than 120 days after the end of the reporting year). The interim IFRS consolidated financial statements, published after six months must also be published for companies that have issued a prospectus and from the group of which it is a part. RAS financial statements are to be included in the quarterly reports which must be published by all companies that have issued a prospectus.

While these provisions appear to have the result that all public companies either use IFRS, or are on a transition path to do so by 2019, in practice this is not quite the position.

According to industry participants, the practice for the majority of companies that issue prospectuses designed for the Russian capital market (i.e., not those that have a listing in foreign markets), is to publish the prospectus using RAS as the primary means of displaying financial information in their prospectus and annual reports. The requirement to publish financial statements according to IFRS is met because financial statements prepared according to both IFRS and RAS are included as an appendix to the reports or prospectus. These financial statements are also published on the websites of issuers and news feeds. However, all the internal disclosures in the prospectus and annual (and quarterly) reports) use, as their basis, the financial statements prepared according to RAS. According to industry participants, the discussion of financial results and commentary are based on the RAS information.

The companies that have sought listings in foreign countries (approximately 50–60) prepare prospectuses and annual and quarterly reports which are fully compliant with IFRS throughout.

Insofar as is used for financial accounts, it meets the IOSCO requirements with respect to the requirement for a balance sheet, the results of operations, the statement of cash flow and the statement of changes in ownership equity. IFRS also meets the requirements with respect to

the criteria that they be comprehensive, designed to serve the needs of investors, are consistent and comparable from year to year and are internally acceptable.

The authorities state that RAS are being brought into compliance with IFRS and will be fully in line by 2017. RAS include a requirement for a balance sheet, a statement of results of operations, a statement of cash flow and a statement of changes in ownership equity.

In principle, both IFRS and, according to CBR, RAS, require financial statements to be comprehensive, designed to meet the needs of investors, reflect consistent application of accounting standards, and be comparable if more than one accounting period is presented.

However, according to CBR (and supported by published advice from accountancy firms), RAS differ from IFRS in the following material respects:

Although the RAS emphasize the principle of “substance over form,” in practice, this principle is not observed, with greater attention being devoted to form over substance;

RAS gives primacy to the legal form of a transaction, according to the documentary record, rather than to economic substance according to professional judgment, whereas IFRS allows more scope for professional judgment in respect of such matters as the cash flow, the choice of discount rate to calculate present value, the classification of instruments such as leasing agreements and the determination of the useful length of life of an asset, the depreciation method, and the liquidation cost;

Under RAS, discounting is rarely used to take account of the time value of money except in the case of financial investments. IFRS requires discounting in a wider range of situations; and

Under RAS, the normal practice is to value on a historic cost basis (except for adjustments for impairment), whereas IFRS would normally apply the concept of fair value, which will involve the market value of assets where available.

Industry participants advise that these differences are likely to be significant at times when there is volatility in the market value of assets.

The MoF is responsible for accounting standards (Articles 22 and 23 of Law 402 of December 6, 2011 on accounting—the Accounting Law). Article 25 of the Accounting Law establishes a Council on Accounting Standards whose members are appointed by the MoF and must have professional accounting, finance or audit experience. CBR is also represented on the council. The law states that information on the council’s activity must be open and generally available (Article 25(13)).

Once a new IFRS standard has been agreed internationally, the authorities state that MoF consults the National Organization for Financial Accounting and Reporting Standards (NOFARS). The NOFARS comments on the new standard. The MoF then takes the decision on whether or not to implement the standard. So far, they have always done so. Article 27 of the

	<p>Accounting Law makes no direct reference to the NOFARS but defines the steps for the development of standards and these involve making draft standards available to the public, on the internet, giving at least three months for public comment. The NOFARS must take account of any written comments, make its view known to the MoF and supply copies of written comments. The MoF takes the final decision.</p> <p>The NOFARS is a non-profit entity that won the tender to act as the independent reviewer of accounting standards in 2011. It is appointed by the MoF and, in that sense, independent of the profession, although it includes prominent members of the profession (again, appointed by the MoF) to provide expertise. Its services are based on an agreement with the MoF. There are informal meetings about the work of the NOFARS but the MoF has no right of inspection or other check on the processes.</p> <p>Article 6 of the Financial Reporting Law gives CBR the responsibility for supervising the provision and publishing financial statements. CBR is also given responsibility for the regulation of accounting in the Accounting Law (Article 22). CBR states that, in practice, it examines a sample of accounts. It monitors for compliance with IFRS but relies mainly on auditors to confirm that IFRS has been properly applied. There has never been any instance of CBR requiring a company to resubmit its accounts on the basis that they do not comply with IFRS.</p> <p>No data has been supplied on enforcement activity with respect to accounting standards</p> <p>Public offerings by foreign issuers are not significant in the Russian Federation.</p>
Assessment	Partly Implemented
Comments	<p>In practice, the large majority of companies that have shares widely held by the public are under an obligation to publish financial statements according to IFRS and those that are not yet so obliged will have either come under such an obligation or gone private by 2019.</p> <p>However, the rating is given because, in practice, all but 50–60 of the companies that are subject to the IFRS requirement meet it in form alone, solely by including IFRS based financial statements in an appendix. The main disclosures in prospectuses and periodic reports are made according to RAS. The information provided by CBR indicates that RAS cannot be described as being an internationally accepted body of accounting standards.</p> <p>This rating should strictly, be “Not Implemented.” However, as there is a formal sense in which the IFRS statements are being disclosed, the rating has been upgraded to “Partly Implemented.”</p> <p>Although the MoF and NOFARS meet the criteria with respect to oversight and transparency, the assessors were surprised that the tender for the NOFARS to be the body that carried out the consultation on new standards to be given only once and indefinitely. It would be better to retender this from time to time.</p>

	<p>The assessors also noted that there were no instances of companies being required to resubmit accounts because of non-compliance with IFRS. Given that most countries experience difficulties introducing IFRS, this result appears to be unusual and may reflect inadequate enforcement of the IFRS requirement.</p> <p>The assessors would also observe that the legislation is extremely complex. The requirements for financial statements rely on the Accounting Law, the Financial Reporting Law, and the Securities Law. In some cases, it is necessary to see the provisions in one law, in the light of the provisions in another law to come to the final legal obligation. It may be this complexity that has created the loophole, whereby many companies meet their requirements to publish accounts according to IFRS by including them in an appendix, rather than in the main prospectus and annual report. The result is a further case of form being adhered to but the substance ignored, in that, in theory, the statements are published according to IFRS but in practice, the main disclosures are written according to RAS.</p> <p>Recommendations</p> <p>CBR should continue its program of progressively obliging public companies to publish financial statements according to IFRS. In addition, they should require those companies that are subject to a requirement to publish accounts according to IFRS to use the IFRS accounts as the basis for the narrative and other disclosures in the prospectus and quarterly reports.</p> <p>The MoF should consider amending the agreement with the NOFARS to give MoF formal oversight powers to enable it to check that the internal processes are sufficiently transparent. Such a provision should be included in future agreements with organizations that may win the tender to act as the independent adviser on accounting standards in the future.</p>
Principles for Auditors, Credit Rating Agencies and Other Evaluative Services	
Principle 19	Auditors should be subject to adequate levels of oversight.
Description	<p>Auditing is governed by Law 307 of December 30, 2008 on auditing (the Auditing Law).</p> <p>The law provides for audit standards (Article 7) that must be observed. It states that an Audit Council (discussed below) shall establish independence standards and a Code of Professional Ethics (Article 16). Audit firms are obliged to follow the Code of Ethics (Article 7) and the Rules of Independence (Article 10). Audit firms are required to establish and observe internal audit work quality control rules.</p> <p>The Auditing Law sets out the oversight and implementation regime for enforcing the requirements on Audit Standards, Code of Ethics, Independence Rules, and internal quality assurance.</p>

The oversight regime is headed by the MoF, that is generally responsible for overseeing all audit activity and for setting audit standards (Article 15).

The MoF acts on the advice of the Audit Council (Article 16), which reviews audit standards and provides an opinion on new audit standards.

The Audit Council has a fixed membership of 16. There are ten representatives of users of financial statements. The MoF also has two representatives on the council, and CBR, one. There are also two representatives of the auditor SROs and one from the MED.

To fill the ten places for users of financial statements, the MoF invites nominations from associations representing banks, insurance, small, medium- and large-sized businesses, professional securities firms and other users. The MoF vets the nominations to ensure they are proper people to sit on the committee. It then appoints them. The first nomination was in 2012. In 2016, each of the user associations previously represented and other user groups were invited to send nominations. Some changes were made. These changes met the requirement in the act that 30 percent of the users' representatives should be rotated every three years.

There are five separate auditor SROs. The SROs choose the two members to represent them on the Audit Council. The law also requires the representatives of the SROs on the Council to be subject to regular rotation

The detailed work of the Audit Council is conducted by its Working Committee, at least 70 percent of whose members must be from the audit SROs. The MoF is also represented on the committee. The SRO representatives are subject to regular rotation.

On receiving a suggestion for an auditing standard (or a new international standard), the Audit Council consults the Working Committee, which prepares a detailed proposal. The proposal is subject to public consultation. The Audit Council makes a recommendation to the MoF, which takes the final decision. As a matter of policy and practice thus far, the MoF has always followed the recommendation of the Audit Council. The Audit Council has not always accepted the proposals of the Working Committee.

For major public interest firms, (such as listed companies, banks, insurance and significant public enterprises) compliance with audit standards is checked by the FFFSS. This is part of the MoF.

Article 9 states that the FFFSS must conduct scheduled inspections of audit firms that audit listed companies once every two years. The FFFSS has 66 inspectors (of which 11 are in territorial units). In 2015, it conducted 258 inspections of audit firms. In addition, it carried out special investigations into specific audit firms that had been inspected in the previous year and for which there was cause to make a special investigation. The FFFSS has access to all documents of auditors, including their working papers. As a result of the inspections, the FFFSS:

	<p>Gave 144 written warnings about the violation of the law, audit standards, independence rules or the ethics code;</p> <p>Issued 29 directives to eliminate violations;</p> <p>Gave 5 binding directives suspending audit firm’s membership in an SRO (which suspends its ability to practice);</p> <p>Issued 1 directive to an SRO to expel an audit firm from an SRO; and</p> <p>Conducted 23 administrative proceedings.</p> <p>Article 20 gives the FFFSS the right to instruct an SRO to suspend or expel an auditor or audit firm.</p> <p>The level of resources and funding available to the MoF for the purposes of oversight appears to be adequate.</p> <p>Article 3 of the Auditing Law obliges all audit firms to be members of an SRO. Article 4 prohibits a person from practicing as an auditor unless he or she is a member of one of the five SROs. An SRO must have 700 members or 500 audit firms (Article 17). As noted above, SROs must set and enforce standards on independence, ethics, and quality control. The standards on ethics and independence must follow those of the Audit Council and are therefore consistently applicable to members of all five SROs.</p> <p>The SROs must conduct inspections of firms on their application of audit standards as well as compliance with independence rules, the ethics code and quality assurance rules. The SROs must conduct inspections of audit firms (including those inspected by the FFFSS once every three years but not more than once a year unless there are grounds for an unscheduled inspection (which are, in effect, reasonable suspicions of a breach of audit standards). The SRO has access to all the documents of an auditor. Article 17 requires an SRO to have a system of disciplinary sanctions both for individual auditors and audit firms and Article 18 sets out the requirement for an SRO to terminate the membership of an individual auditor or audit firm for breach of the regulations.</p> <p>Article 20 of the Auditing Law permits an SRO to issue an order to a member to eliminate any breaches of audit standards or SRO rules.</p> <p>The MoF is responsible for supervision of the work of the SROs, and must carry out this task solely by onsite inspections (whether scheduled or unscheduled). The MoF has, thus far, conducted ten scheduled and ten unscheduled inspections of the SROs in the two years preceding the assessment. The MoF is developing a methodology for testing effectiveness of its oversight process.</p>
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	<p>Discussions with audit firms indicates that the inspection regime is regarded as effective.</p> <p>Article 11 of the Auditing Law prohibits an auditor from practicing unless he or she has a qualification certificate issued by an SRO. This is issued following an examination and with a work record of three years of which two must be with an audit firm. The examination is set by the MoF. Article 11(9) sets minimum requirements for continuing professional development (CPD). Failure to complete the CPD requirements can result in a qualification certificate being annulled (Article 12). This would prevent an auditor from being a member of an SRO and from practicing (Article 18).</p>
Assessment	Fully Implemented
Comment	
Principle 20	Auditors should be independent of the issuing entity that they audit.
Description	<p>Article 8 of the Law obliges the SROs to adopt the standards for independence that are set by the Audit Council.</p> <p>The Audit Council has published a Code of Professional Ethics and Independence Rules. Compliance with both is mandatory according to the Auditing Law (Articles 7 and 16). The Code of Ethics states that compliance with the rules of independence is mandatory. The Independence Rules defines the key elements of independence as being:</p> <ul style="list-style-type: none"> a) independence of thought, i.e., a way of thinking that allows the auditor 1) to express an opinion that is independent from the influence of factors that could compromise the auditor's judgment; and 2) to act honestly, exercise objectivity and professional skepticism; and b) the independence of behavior, i.e., behavior that avoids situations and circumstances that are so significant that a reasonable and informed third party, weighing all the facts and circumstances might reasonably consider that the integrity, objectivity or professional skepticism had been compromised by the auditor. <p>The rules then give extensive detail on the actions to be taken to avoid threats to independence.</p> <p>Independence is also provided for in the Auditing Law. Although this does not have a general requirement to act independently, it prohibits a range of actions that might threaten independence, such as the audit firm officials being founders or stakeholders in the audit client, or in affiliates, or there being common founders and personal family relations between auditor and client. It also prohibits audit firms from undertaking audits when they have provided bookkeeping services in the previous three years, or where the audit client provides insurance services to the audit firm. There is a general conflict of interest provision that prevents an auditor or audit firm from providing audit services where a conflict of interest would affect (or might threaten to affect) the audit opinion.</p>

	<p>The Code of Ethics also addresses the question of self-interest, self-review, advocacy, familiarity and intimidation. It provides detailed guidance on measures to take to avoid the risks posed by these factors.</p> <p>The Auditing Law does not prohibit the provision of other non-audit services to the audit client but it does have a general prohibition on any relations between the audit firm and the audit client that may compromise independence or conflicts of interest. There is a specific prohibition on the provision of audit services where the auditor has provided bookkeeping services in the last three years (Article 8(1)). The provision of such services is also covered in the Code of Ethics. It discusses the threats that are created and identifies measures to mitigate the risks.</p> <p>Article 10 of the Auditing Law states that an audit organization must have internal quality control checks. While it is not directly stated that this addresses independence, the auditor is required to obey the independence rules, which are an essential part of the required procedures. There are no mandatory requirements relating to rotation of auditors. The Code of Ethics and the Rules of Independence describe rotation of the group management team or senior staff of the audit team as a policy that might be considered.</p> <p>The Code of Ethics and Rules of Independence contain general principles as well as detailed provisions. They both make clear that the rules for ethics and independence are based on a conceptual approach that is designed to establish a principle rather than being based on a set of rules. The code makes clear that it would not be possible to establish a rule that covered all threats to ethical behavior and independence and that the auditor should follow the general principle.</p> <p>There are no mandatory provisions that require governance arrangements in public issuers that ensure the selection of external auditors is undertaken by a body independent of management. However, the voluntary Corporate Governance Code (Paragraph 172(3)) recommends that the Audit Committee develops proposals for the election, re-election and dismissal of the auditor and for the oversight of the independence of the auditor. There are no other governance standards intended to safeguard auditor independence. There is no requirement for the resignation, removal or replacement of the auditor to be disclosed.</p> <p>Article 20 of the Auditing Law permits an SRO to issue an order to a member to eliminate any breaches of audit standards or SRO rules.</p> <p>The oversight and monitoring program described above in Principle 19 also covers independence. However, the FFFSS stated that they had not identified any breaches of independence and noted that it was often difficult to prove a violation of such a broad principle, unless one of the specific matters defined in the Auditing Law had been breached.</p> <p>Moreover, the perception in the profession was that there was no general understanding and acceptance of the principles of independence. As noted elsewhere in this assessment, there is a strong tradition in Russian law and regulation that sanctions can only be applied in respect of</p>
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	<p>specific rules rather than overall principles. Consequently, if there is no specific rule, and an audit firm did not fear a sanction, the firm would not be likely to limit its behavior as suggested by a general principle. By way of example, it was noted that it is often the case that an accounting firm would conduct a valuation of an asset and then, as auditor, conduct an audit of the financial statements of the firm owning that asset. Even though this clearly offends against the “self-review” principle, the audit profession suggested that there would be many auditors who act as described, since there was no specific rule prohibiting the practice.</p>
Assessment	Partly Implemented
Comments	<p>This rating is given because of:</p> <ul style="list-style-type: none"> • The apparent incidence of behavior in the market that conflicts with the independence principle. • The absence of provisions requiring governance arrangements that ensure that the selection of auditors and the oversight of auditor independence is, in the case of public issuers, carried out by a body independent of management. • The absence of any requirement to disclose the resignation, replacement or removal of an auditor. • The absence of any requirement mandating auditor rotation. <p>Strictly speaking, these items should result in a “Not Implemented” rating. However, the fact is that there are substantial provisions in place that require independence, both in principle and through detailed provisions. There is also an inspection program that is generally effective, and must be presumed to have had some effect in promoting independence in behavior. For this reason, the grading has been raised to “Partly Implemented.”</p> <p>CBR have observed that Article 8 (1)(4) and (3) of the Auditing Law includes provisions that prohibit the provision of non-audit services and deals with governance arrangements relating to the appointment of auditors. However, Article 8(3) only prohibits the provision of audit services to a company for which the auditor has provided bookkeeping in the past five years and Article 8(1)(4) is a general prohibition on conflicts of interest. Neither article includes any general provision on the supply of non-audit services and neither make any reference to governance.</p> <p>Recommendations</p> <p>The Auditing Law (or other legislation as appropriate) should be amended to include:</p> <ul style="list-style-type: none"> • A general provision prohibiting financial business, corporate and personal relations between an auditor or audit firm and the client and any other relationships or behavior that might threaten or reasonably appear to threaten independence.

	<ul style="list-style-type: none"> • A general provision that prohibits the provision of any non-audit services to an audit client where such services may be of a nature or scale that would compromise or appear to compromise the independence of the auditor. • Provisions requiring governance arrangements that ensure that the selection of auditors and the oversight of auditor independence is, in the case of public issuers, carried out by a body independent of management. • A requirement to disclose promptly the resignation, replacement or removal of an auditor and the reasons for the change. <p>The assessors recommend that the Audit Council consider ensuring that audit and ethical standards include the requirement that internal quality controls directly address independence and that there are mandatory measures to require the rotation of individual auditors, if not audit firms, so as to safeguard independence.</p> <p>The MoF is recommended to increase the priority given to assessing auditors' independence in substance as well as form, when conducting inspections.</p>
Principle 21	Audit standards should be of a high and internationally acceptable quality.
Description	<p>As noted in Principle 16, financial statements that appear in a prospectus must be audited (Article 22 of the Securities Law) as must those that appear in annual reports (Article 30).</p> <p>Article 7 of the auditing law requires all audits to be conducted according to Russian auditing standards. The MoF (MoF) indicates that Russian audit standards are not yet in line with International Standards of Auditing (ISA) but full compliance is intended by 2017. However, the MoF also stated that audit firms had been required to adopt ISA prior to the formal adoption of ISA. Inspections covered by the FFFSS check audit standards for compliance with ISA. This includes all public interest companies, including all listed companies.</p> <p>Article 7 of the Auditing Law provides for the updating of audit standards. The Audit Council reviews such standards (Article 16) and the MoF is responsible for implementing new standards. The process by which the Audit Council reviews standards is reasonably transparent. The Audit Council itself includes representatives of users of financial statements and its working committee includes a majority of representatives of SROs (see Principle 19). These are the main stakeholders in connection with audit standards. The Audit Council published drafts of the new standards and drafts of its opinions for comment.</p> <p>Compliance with audit standards is monitored by SROs and the FFFSS. The MoF conducts oversight of the SROs.</p> <p>For major public interest firms, such as listed companies, banks, insurance and significant public enterprises, compliance with audit standards is checked by the FFFSS.</p>

	<p>Details of FFFSS oversight actions are given in principle 19.</p> <p>Article 20 gives the FFFSS the right to instruct an SRO to suspend or expel an auditor or audit firm.</p> <p>In addition, SROs monitor the implementation of audit standards, independence rules, ethics standards, and quality assurance rules for all audit firms (including those inspected by the FFFSS).</p>
Assessment	Fully Implemented
Comments	
Principle 22	Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing
Description	<p>Article 2 of the Law 222 of 13 July 2015 on Credit Rating Agencies (the CRA Law) defines a CRA and credit rating activity.</p> <p>A CRA is defined as:</p> <p><i>a legal entity established in the organization and legal form of an economic company in compliance with the legislation of the Russian Federation which is entered by CBR into a register of credit rating agencies in compliance with the requirements of this federal law and is exercising rating activities;</i></p> <p>Credit rating activity is defined as:</p> <p><i>the professional activities exercised on a permanent basis that lie in aggregate in preparing, assigning, confirming, reviewing, as well as withdrawing, ratings and forecasts of credit ratings (hereinafter referred to as rating actions) on the basis of analysis of information in compliance with the methodology and accompanied by dissemination of information about the awarded credit ratings and forecasts of credit ratings in any way providing access to it of an unlimited circle of persons.</i></p> <p>Article 3 says that CRAs must be registered and no other legal entities are entitled to carry out rating activities.</p> <p>Article 5 sets out the criteria for refusing registration which are:</p> <ul style="list-style-type: none"> • failure to submit information; • submitting false information; or • failing to meet the regulatory requirements in the law, including (but not restricted to) fitness and properness criteria (Article 6–8) and measures to prevent conflicts of interest (Article 9).

Article 4(2) of the CRA law requires the applicant for CRA registration to provide all the documents prescribed by CBR. CBR has no power to ask for any other documents, although it can ask for explanations. The information to be supplied is to be set out in a new regulation that will govern the licensing procedure. CBR informed the assessors at the time of the assessment that no CRAs can apply to be registered until that is in place.

The fitness and properness criteria apply to the owners holding more than 10 percent of the equity in the CRA (Article 6) and there is a prohibition on banks or insurance groups holding more than 20 percent of the equity (Article 6(6)). The fitness and properness criteria also apply to managers and internal control bodies (Article 7).

The integrity tests in the CRA law are more extensive than those for people in equivalent positions of seniority in securities firms. They also include highly specific matters (such as being in a management position in a company that was criticized for unreliable financial statements or unexpunged convictions for international crimes). In all, there are 15 integrity tests. But there are gaps in what is included. For example, the integrity tests do not include such matters as adverse findings by a professional organization or SRO. Also, there is no reference in the statutory tests to the implications of employment termination by a previous employer (unless they have resulted in multiple terminations).

The rigid structure of the tests also eliminates any exercise of discretion by CBR to take into consider the seriousness of the matter in question, or its relevance to the position in question. Administrative disqualifications are disregarded after they have been completed, regardless of the seriousness of the incident that led to the disqualification. The test on criminal convictions applies only to unexpunged international crimes (however serious) and not to other crimes (again, however serious).

Articles 3(10) and (11) states that a representative office of a foreign CRA must be registered as a subsidiary of a foreign CRA in order to be able to carry out rating activities. A branch of a foreign CRA that is located in the Russian Federation can carry out rating activities so long as the ratings are assigned, affirmed, reviewed, and withdrawn on behalf of the foreign CRA. It will not be subject to the main requirements of the CRA law covering such matters as the governance, methodology, or supervision, on the basis that the regulatory authority in the home country will be responsible for those matters. CBR will satisfy itself as to the adequacy of the foreign regulatory regime and will enter into information exchange arrangements with the home regulator.

CBR has the power to obtain information from CRAs and to conduct ongoing supervision. Article 15 (1)(5) gives CBR the power to conduct inspections of the CRA and 15(1)(9) gives the power to collect information. Article 7 of the CRA Law requires prior notification of the appointment of the CEO and head of internal control in order to give CBR the opportunity to give or deny approval. Article 7(11) requires that a CRA file documents with CBR on the work of and persons employed by their Internal Control Department. Article 13(6) requires CRAs to

submit documents to CBR relating to its rating activities. Article 15(1)(10) also requires the CRA to provide documents and information that CBR deems necessary.

Article 15(1)(6) gives CBR the power to send instructions to remedy any violations. It can remove the CRA from the register if it fails to comply. Deregistration would mean that it could no longer give ratings. CBR can require the CRA to remove staff on its management body and internal control body (Article 7(3) of the CRA Law).

The CRA Law (Article 12) requires CRAs to adopt and implement a written methodology as the basis for ratings and the application of all the relevant information at the CRA's disposal. The methodology should be disclosed on the CRA's website (Article 13). Article 12 further requires that there should only be departures from the methodology when special circumstances would mean the methodology would lead to a distortion and any such departure should be documented and disclosed on the CRA website. If there are more than three departures from the methodology in a quarter, there must be a review of the methodology. Any amendments to the methodology should be disclosed. The CRA should consider if other credit ratings need to be reviewed—and if so, to conduct that review within six months (Article 12(12)).

If information received from the client in respect of a rating is insufficient to apply the methodology properly, the CRA should refuse to assign a rating (Article 12). Article 12 also prescribes certain features of the methodology.

Article 12 also requires the establishment of a methodology committee, which approves and reviews the methodology and whose internal papers are filed with CBR. It further requires ratings to be monitored and reviewed within stated time periods (at least within a year). Article 11 of the CRA law mandates the creation of a rating committee to undertake ratings in accordance with the CRA procedure.

There are no specific provisions requiring CRAs to maintain records. CBR state that this will be covered in a forthcoming regulation.

There is no specific provision requiring CRAs to have sufficient resources to apply their methodology thoroughly and robustly and maintain internal controls.

There is a range of provisions seeking to maintain the independence of the rating decisions. Article 3(3) of the CRA law prohibits the CRA from conducting activities other than those specified in Article 9(9), which are certain ancillary services like market forecasts, performance assessments, ratings other than credit ratings, trend analysis, pricing and other analyses, and services not creating a conflict of interest. There must be no consulting services (Article 9(12)). Article 3(9) also requires CRAs to ensure their independence from political or economic influence. Article 8(2) includes governance requirements that ensure that larger CRAs employing more than 20 employees must have at least two (or one third, if greater) independent members of the governing board. Article 10(5) mandates a rotation system for

	<p>lead analysts permitting no more than four years on one entity (five years for sovereign ratings) (Article 10(6)), with a two-year layoff before returning.</p> <p>Article 3(9) requires CRAs to identify and prevent conflicts of interest or, if not prevented, manage and disclose them. Article 6(1) prevents a founder of one CRA from being the founder of another. Article 9(6) also limits associations between CRAs, founders, and management. Article 10 forbids various specified relations between analysts and rated entities, such as labor or business relations or shareholdings. Article 9 obliges CRAs to prevent existing and prospective conflicts of interest. They should disclose them if they might affect analysis and opinions of analysts.</p> <p>The internal control bodies should seek to prevent conflicts of interest and carry out an annual performance assessment of rules and procedures. Article 9 requires the CRA to review the credit ratings that may be subject to an identified conflict of interest.</p> <p>The remuneration of the board must not be related to performance. Remuneration must be set so as to ensure independence (Article 8(6)). Article 10(7) makes the same requirement with regard to the rating analysts and rating committee chairmen. Article 9(8) forbids the fee charged by a CRA from being related to the level of the rating or consent of the rated entity. Rating analysts must not have shares in the CRA. There must be no gifts above RUB 3,000 (Article 10(9)). Article 13(1)(2) requires the disclosure of all other conflicts of interest.</p> <p>Transparency and timeliness are also covered by the following provisions:</p> <ul style="list-style-type: none"> • Credit ratings must be published on the website of the CRA (Article 14). The regulated entity can have at least one business day to review the rating for factual mistakes. • Article 13 requires the publication of the methodology, a description of models (including methods of their calculation and building), key rating assumptions, lists of all quantitative and qualitative factors (with indication to the limits for expert judgments on each such factor), and data sources. • Article 13 also requires the publication of historical default rates. <p>Article 9(13) obliges a CRA to maintain the confidentiality of information obtained from a rated entity.</p> <p>At the time of the assessment no CRA had registered under the law, because the full regime has not been completed. New regulations on licensing and other matters are being prepared.</p>
Assessment	Not Implemented
Comments	<p>The CRA Law is very comprehensive and clear and is manifestly designed to address the issues identified in the IOSCO Principles and the IOSCO reports and Code of conduct on CRAs. However, the rating is given because:</p>

	<ul style="list-style-type: none"> • The regulatory regime is not yet completed and no CRAs are registered or subject to regulation; • There is no power for the CRA to ask for additional documents, if the documents it receives prompt a further enquiry; • There is no general requirement in the law relating to record keeping; • There is no specific requirement relating to the sufficiency of resources; and • The integrity tests for senior positions give insufficient scope to CBR to consider the substance of any matter in question and its relevance to the position the person is likely to fill. <p>It is important that CBR should be able to insist on disclosure of a wider range of matters affecting integrity and should be able to consider the relevance of such matters in the context of the position to be held. The wider disclosure should include findings by any professional association or SRO, any employment dismissal (or resignation, where failure to resign would result in dismissal). Personal bankruptcy or agreement with creditors (where bankruptcy would otherwise result) also should be disclosed.</p> <p>Ideally, there should be a more general disclosure obligation to report any matter that might reasonably affect the judgment of CBR as to the suitability of a person to hold the relevant position in the CRA.</p> <p>Recommendations</p> <p>CBR should complete the process of writing regulations so that the law can come into effect.</p> <p>The CRA Law should be amended to include:</p> <ul style="list-style-type: none"> • A general record keeping requirement (although the new regulation will no doubt specify certain records to be kept, the primary law itself should impose a record keeping requirement that is broad enough to ensure that all appropriate records are kept to demonstrate the compliance of the CRA with the regulatory requirements, the operations of the business and the practical implementation of rating methodology). • The power for CBR to require the CRA to provide additional information. • An obligation on CRAs to maintain sufficient resources to be able to apply the methodology with all relevant information rigorously and robustly. • An expanded integrity test, with a broader disclosure requirement and the discretion of CBR to consider whether the matters disclosed should prevent or permit the person from taking the position in questions taking account the seriousness of the matter disclosed and its relevance to the position sought.
Principle 23	Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.

Description	<p>There is no procedure within CBR for reviewing periodically whether or not there are entities providing analytical or evaluation services that warrant regulation.</p> <p>In discussion with CBR, it was established that there were two kinds of services provided in the Russian Federation that should be addressed in accordance with this principle:</p> <ul style="list-style-type: none"> • Analysts, working for brokers, who provide reports on securities to customers; and • Appraisers, whose role is to provide valuations that may be relevant to disclosures by issuers and collective investment funds (such as valuations of individual assets) as well as to valuations of CIS, taken as a whole. <p>Analysts working for brokers are providing investment advice. Investment advice is not a regulated activity in the Russian Federation. There are no provisions directly related to such analysts. However, CBR has concluded that investment advisers should be brought into regulation in the future.</p> <p>Insofar as such analysts were employed within broking firms, they would be subject to regulation and supervision as part of CBR's overall supervision of brokers. The general conflicts of interest provisions applying to such firms. These provisions are described in Principle 31. Articles 3 and 5 of the Securities Law impose a liability on a broker or manager to compensate a client that suffers loss as a result of a conflict of interest. Licensing Instruction 168 obliges a license applicant to supply a list of measures designed to address conflicts of interest, where a license applicant conducts more than one kind of activity. However, it is clear that this is referring to an applicant conducting more than one kind of licensed activity. Since the analysts' activity is not separately licensed, the instruction would not apply to such cases.</p> <p>CBR have identified a further regulation addressing conflicts of interest, namely Regulation 44 of 1998 on conflicts of interest. This gives a general definition of conflicts of interest as being a conflict of interest between a professional securities market firm (and its employees) on the one hand and the client on the other. SROs are required to devise measures aimed at averting conflicts of interest and securities firms are required to operate on the basis that a client's interests should be given priority over their own. This regulation would apply to brokers and therefore to analysts.</p> <p>In respect of analysts, there are no provisions:</p> <ul style="list-style-type: none"> • Directed at identifying and addressing conflicts of interest that are likely to apply to analysts (apart from the 1998 regulation referred to above); • Relating specifically to trading activities of the analysts themselves; • Restricting the business relationships of the entities that employ them; • Placing constraints on their reporting lines;
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	<ul style="list-style-type: none"> • Requiring internal procedures to identify, eliminate, manage or disclose conflicts of interest; • Requiring procedures to eliminate or manage the influence of issuers; • Requiring disclosure of conflicts of interest by management; and • Specifying behavioral norms designed to promote integrity and high ethical standards. <p>Appraisers are subject to regulation according to Law 135 of July 29, 1998 on evaluation activity (the Appraisers Law). This contains a number of provisions designed to address conflicts of interest. These include:</p> <ul style="list-style-type: none"> • A requirement to be a member of a SRO and follow the ethical regulations established by that SRO (Articles 15, 20.1 and 22.1); • Requirements for independence that prevent the appraiser from undertaking an evaluation of an object, where the appraiser is a founder, shareholder, official, employee, member, or creditor of the client (or a close relative of such a person), or has a property, proprietary or liability right or interest in the object being evaluated (Article 16); and • The client must not interfere with the appraiser's activity and the remuneration must not depend on the valuation (Article 16). <p>The authorities have not provided copies of the ethics standards of the SROs of appraisers and therefore no assessment can be made of the extent to which such ethical standards meet the criteria for this principle.</p>
Assessment	Not Implemented
Comments	<p>There is no process in place for assessing whether or not there are activities that fall to be regulated under this principle.</p> <p>It appears that currently, there are investment analysts and appraisers that may be covered by this principle.</p> <p>Analysts are not regulated and, insofar as they are covered by the regulations on brokers (for whom they will normally work), the provisions on conflicts of interest are inadequate.</p> <p>The authorities have not provided copies of the regulations and codes that cover the activities of appraisers.</p> <p>The existing provisions relating to analysts do not address the requirement of this principle. The assessors have taken note of the 1998 Regulation on conflicts of interest to which CBR have drawn attention but do not consider it to be effective for the following reasons:</p>

	<ul style="list-style-type: none"> • CBR have explained that generalized requirements of this kind are deemed to be “declaratory” in nature and difficult to enforce; • The general requirement is not supported by more detailed requirements (and any standards introduced by SROs could be avoided by brokers who chose to resign from an SRO, since the new SRO Law making SRO membership mandatory is not yet fully in force); • The regulation was not referred to in the CBR’s self-assessment and was not referred to by private sector interlocutors or CBR until the final meeting with the mission— suggesting that it is not widely understood or actively enforced; • The only direct obligation of the regulation is to give client’s interests priority over those of the professional securities firm and it is not clear that this is relevant to an analyst publishing professional opinions about securities to a group of clients or perhaps the public more generally. <p>The assessors cannot determine whether or not the provisions in relation to appraisers are consistent with this principle.</p> <p>Recommendations</p> <p>The recommendations with respect to investment advisers in Principle 29 also is relevant here.</p> <p>CBR should create regulations that specifically address the potential conflicts of interests of analysts when introducing a regulatory regime for advisers.</p> <p>CBR should review the ethical standards of the SROs for appraisers to ensure that all the requirements of this principle are met.</p>
<p>Principles for Collective Investment Schemes and Hedge Funds</p>	
<p>Principle 24</p>	<p>The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.</p>
<p>Description</p>	<p>Under the law there are two forms of investment funds: joint stock funds and UIFs. Joint stock funds are structured as corporations that offer their shares to investors (similar to U.S. mutual funds); UIFs are structured as contracts with individual investors. They do not have legal personality (similar to U.K. unit trusts). As referenced in IOSCO’s June 2006 report Examination of Governance for Collective Investment Schemes they correspond to the “corporate model” and the “contractual model,” respectively. Joint stock funds have been declining in importance for several years and only three remain. Consequently, Principles 24–28 are assessed primarily by reference to the regulation, supervision, legal form, marketing, and operation of UIFs. Joint stock funds and their operators are subject to similar regulation with variations specific to their corporate structure.</p>

	<p>A UIF must have a trust MC and a SD, both of which are licensed by CBR. The term “trust” in a CIS context refers simply to the Russian Civil Code concept of the obligation to act in the best interests of the client. Funds can be open, closed or interval.⁶ There are also exchange traded funds (ETFs). The largest part of the CIS market consists of funds invested in real estate and securities based on real estate such as mortgage bonds. Open UIFs for “unqualified” investors (essentially retail investors) can invest only in the latter and not directly in bricks and mortar. Funds for “qualified” investors (such as financial institutions, high net worth individuals and those with experience in investing in securities) cannot be marketed to the general public. Many such funds are, in reality, vehicles for the management of the assets of individual wealthy individuals, and families. In the Russian regulatory structure, “fund rules” are the equivalent of a prospectus or offering document in IOSCO terminology.</p> <p>The Investment Funds Law specifies the responsibility and defines the powers of CBR and relevant SRO with respect to licensing, regulation, oversight, and supervision of UIF MCs.</p> <p>Article 55.1 defines the comprehensive, overarching powers of CBR in the CIS sector. CBR regulates the activities of joint-stock investment funds, MCs, SDs, agents for issuance, redemption and exchange of investment units, and persons that keep registers of investment unit holders.</p> <p>Eligibility criteria</p> <p>Marketing a CIS</p> <p>Under Article 27 of the Investment Funds Law, only specialized depositories and professional participants in the securities market holding a license to carry on brokerage activity or to keep the register of securities owners may act as agents engaged in allocation, redemption, and exchange of units. This includes banks that have brokerage licenses. In practice, 50 percent of the sales of CIS are made by banks. Most sell only funds of their affiliated MCs. A brokerage license has no special conditions specific to marketing CIS. Agents can also act as the recipients of instructions to redeem units that it passes on to the MC.</p> <p>An agent must indicate to investors that he is acting on behalf of, and in the name of, the MC of a specific investment fund and must also show his power of attorney issued by the MC to all persons concerned.</p>
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⁶ Open ended funds give the unit holder the right to redeem some or all of their holdings at any time.

Closed end funds do not give the unit holder the right to redeem until the term of the management contract has expired.

Interval funds give the unit holder the right to redeem some or all of their holding but only on the dates specified in the funds’ rules.

ETFs have a more complex structure. A unit holder is entitled to demand that a person authorised by manager purchases all or any part of their holding at any time, and also a right to sell their units on the stock exchange specified in the fund rules at any time. The authorized person is entitled to redeem those units on dates set out in the fund.

	<p><i>Operating a CIS</i></p> <p>The main requirements for the establishment and operation of MCs and SDs of UIFs are found in Article 60.1 of the Investment Funds Law. The More detailed operational requirements for MCs are specified in the Decree of the Federal Service for Financial Markets (FSFM) of Russia of February 18, 2004 No. 04-5/ps "On regulation of the management companies of joint-stock investment funds and mutual funds." Under paragraph 4 of Article 38 of the Investment Funds law, an MC cannot also be a broker.</p> <p>The detailed licensing conditions for an MC and SD include conditions as to:</p> <ul style="list-style-type: none"> • its organizational and legal form; • its shareholders; • the amount of own assets; • the members of the board of directors (supervisory board); • members of the executive board and the head and employees of the internal control service; and • its arrangements for internal controls. <p>CBR does not have the power to carry out an onsite inspection prior to granting a license.</p> <p>An MC must be a joint stock company or a limited liability company and when that is created the tax authority checks that it exists at the address stated. CBR does, however, check the assets and liabilities and the composition of the assets from the documents provided, both at the moment of granting a license and afterwards.</p> <p>As required by Article 60.1.11 CBR checks the license applicant for compliance with the requirements of the Investment Funds Law and other regulatory legal acts of the Russian Federation, including regulatory acts of CBR that regulate the activities of MCs and SDs and, if necessary, requests from them additional information to confirm compliance with the requirements for the amount of equity capital, professional experience of the CEO and head of the internal control service.</p> <p>Specific conditions relate to the required indicia of honesty and integrity of persons in senior positions of an MC. Under Article 38.10 of the Investment Funds Law the following persons shall not be a member of the board of directors, the CEO or any other member of the senior management group, or the head of a branch of an MC:</p> <ul style="list-style-type: none"> • the persons who were carrying out the functions of CEO of a financial organization when these organizations committed offenses for which their licenses to pursue relevant types of activity have been revoked or, if the offense was the failure to remedy matters, if less than three years have passed since the date of revocation;
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- the persons to an administrative penalty of disqualification for which the term has not expired; and
- persons having an unexpunged or unabashed conviction for an economic crime or a crime against state power.

There are no other integrity tests beyond these specific items.

Similar restrictions apply to the shareholders in a MC. The applicant MC must also provide information on the persons who possess or manage 5 percent or more of the shares of the applicant whether singly or as part of a group of associates. Article 38.1 states that a natural person having an unexpunged or unquashed conviction for an economic crime or a crime against state power is not entitled to directly or indirectly (through persons controlled by him/her) control 10 percent or more of the voting capital of the MC. A person who, directly or indirectly has acquired the right to control 10 percent or more of the voting capital of the MC must send a notice to the MC and to CBR. CBR is entitled to request and obtain additional information on such persons and will, if it believes it to be necessary in the interests of investors, secure the removal of such a shareholder.

The legislation establishes the qualifications and professional experience requirements for the CEO of an MC and an SD, the head of internal control (the "controller"), and the chief accountant. In particular, paragraph 9 of Article 38 of the Investment Funds Law requires that the CEO of the MC should have a higher education qualification, have passed specific qualification exams, and meet the requirements for a period of professional experience in a financial services company at a senior level. Further qualification requirements that apply to employees of both management companies and specialized depositaries are set by order of the FSFM from January 28, 2010 No. 10-4/pz-n "On the Financial Market Specialists." These criteria are common across the financial markets sector and are discussed further under Principle 29. Requirements on specialists are not particularly specific in terms of professional knowledge and expertise. For example, a person employed to trade derivatives need not have derivatives market experience. It is sufficient that they have worked for two years in a senior position in a financial markets firm. CBR believes that the markets in Russia are still too small, as is the talent pool, for any greater degree of specialized experience to be required.

The legislation is less specific as to the technical resources requirements of an MC. Under the law, the ongoing supervision of the activities of MCs in operating UIFs and managing the day to day operational needs of the funds (such as clearing and settling trades, managing subscriptions and redemptions, keeping accurate accounts and financial records, liaising with the registrar and the banking relationships, etc.) is the responsibility of the SD. Consequently, CBR has taken the view that while an MC needs a basic technical infrastructure, the bank should place most emphasis on the technical resources of the SD (as described in Principle 25), when a licensing an MC.

The Investment Funds Law says little specifically about the expected corporate governance structures or standards of an MC. The CEO is not permitted to be the controller, thus

supporting the independence of the controller, and the prohibitions on persons who may not be on the board or in other senior positions play a part. Since UIF MCs and SDs can be joint stock companies, the provisions of the 2014 Corporate Governance Code, published by CBR in April 2014, apply to both types of entities although the code is not mandatory. As the introduction to the code notes, "corporate governance" is a concept that covers a system of relationships between the executive bodies of a joint-stock company, its board of directors, its shareholders and other stakeholders." In the case of MCs and SDs, this covers unit holders in UIFs. In the Russian structure, the SD is the "responsible entity" in IOSCO terminology and is independent of the MC.

Risk management

CBR is keeping the issue of RM under review, as fund management is becoming more technologically complex, RM by MCs has become more of a focus among regulators globally, and the necessary technical resources and skills of MCs are increasing beyond the need merely to have an electronic signature and stable connections to agents, SDs brokers and registrars. For example, in 2015 CBR carried out a thematic review of the relevance of the current asset composition requirement (regulation on the composition and structure of assets of joint-stock investment funds and assets of mutual funds, approved by Order of the FSFM December 28, 2010 No. 10-79 / pz-n) that is the primary regulatory tool for controlling risk in a UIF. As a result, CBR is developing a draft regulation to make the requirement more meaningful to the management of liquidity risk.

The other current regulatory tool that directly influences the quality of RM in the MC is the requirement that an MC may invest in derivatives for its funds only if it satisfies the CBR requirements aimed at risk limitation in derivatives trading. Indirectly, the MC management is required to report to its board on a quarterly basis on the measures it has employed to reduce the risks associated with the management of its funds (paragraph 5.11 Regulation No. 04-5/ps). CBR Supervision can review these reports when it wishes to and if it identifies weaknesses, can ask for additional explanations. It does not have formal criteria for this analysis but it employs several people with relevant fund management experience who use their personal expertise subject to managerial oversight to secure consistency. Not all reports are reviewed however.

Internal controls

The MC must have an internal document approved by the board of the MC that determines the mechanisms of internal control (paragraph 5.6 of № 04-5 / ps). Article 38.15 of the Investment Funds Act states that the MC is required to arrange internal controls to ensure compliance of the activities exercised on the basis of the MC's license with the rules of the funds it manages, its constitutional documents and all relevant laws and regulations. Article 38.16 requires that responsibility for internal controls must be exercised by a "controller" or by a separate unit of the MC—the internal control service. A controller or the head of the internal control service is

accountable to the board of directors (supervisory board) or a general meeting of the MC's shareholders.

Under Article 38.18, the approval of rules of internal control area is a (supervisory) board responsibility. The rules for arrangement and exercise of internal controls in a MC and the amendments to be made thereto shall be endorsed by the board of directors (supervisory board) or, in the absence thereof, by a general meeting of shareholders of the MC.

Capital

CBR imposes a minimum capital requirement on MCs. According to paragraph 5 of the CBR Direction from July 21, 2014 № 3329-U "On the requirements for own funds of professional participants of the securities market and investment fund management companies, mutual funds and private pension funds," the amount of equity capital (own funds) of an MC must not be less than RUB 80 million and in a form satisfactory to CBR. Acceptable capital includes (without limitation) real estate, listed securities, bank deposits and cash. Other assets which can be included with limitations, include unfinished properties, unlisted securities, deposits in affiliated banks and software. CBR is drafting a regulation which may exclude some assets and impose limitations on others. Capital is not risk based; there are no add-ons for AUM above a certain level. The position with regards to SDs is somewhat different. The base requirement is also RUB 80 million but if the SD uses sub-custodians, this amount is increased if the sub-custodians are, in the view of CBR, insufficiently capitalized.

Supervision and ongoing monitoring

Article 55.2.1.10 of the Investment Funds Law grants a general power to CBR to exercise control and supervision over the activities of MCs, SDs, agents and registrars. Under Article 55.2.1.12 CBR is required to carry out checks on whether these entities meet the requirements of the relevant laws and regulatory acts of CBR that cover their activities. It also has the authority to require the provision of any information on the status of the MC including in the area of internal control (subparagraph 13 of paragraph 2 of Article 55).

Under Article 55.3 CBR is entitled to do the following:

- to hold planned inspections no more than once a year;⁷ and
- to hold "for cause" inspections if the signs of violations have been detected, in particular on the basis of statements/reports and notices of an SD regarding violations, complaints (applications, petitions) of individuals and legal entities and data provided by the mass media.

⁷ This limitation was introduced in the 1990s in response to public disquiet about the abuse of inspection processes by certain federal agencies. "For cause" inspections are not limited in this way.

	<p>Offsite supervision</p> <p>CBR has developed a risk-based approach to supervision of MCs and SDs which builds upon its previous rules or compliance based approach. It combines offsite supervision and onsite inspections. The onsite inspections are carried out by the Inspectorate department, which carries out inspections for all of the CBR's supervisory departments. The offsite supervision department for CIS comprises 75 staff located in Moscow, Saint Petersburg and the Novosibirsk region.</p> <p>MCs and SDs are required to file financial reports with CBR monthly, quarterly and annually with the content and schedule determined by CBR. Consideration of these reports is carried out on a continuous basis. A new direction of CBR from December 16, 2015 No. 3901-U "On the timing and preparation and submission of reports to CBR by MCs and private pension funds" will further enhance the reporting regime. In addition, the department can require MCs and SDs to provide additional or clarifying information at any time.</p> <p>Based on its analysis of the reports filed by the MCs and SD's and other relevant inputs (complaints, media reports, banking supervision referrals, etc.) the department develops a schedule for onsite inspections for the next six months that is then agreed with the Inspectorate. The offsite department sets the agenda for the onsite teams and the type of inspection they wish to see carried out. These may be "deep dive" inspections of a single firms or issue based (thematic) inspections of several firms in a similar time period. If the inspection(s) takes place over a period of several weeks, the onsite team provides the offsite department with weekly updates so that the latter can, if necessary, amend the brief or take immediate action. On its return, the onsite team writes its report that is considered by the offsite department. The director in charge of financial services will be engaged in discussions about the inspection results for larger MCs and with possible serious breaches that the inspection team may have uncovered. Breaches may be followed up with demands for additional information from the MC and eventually a decision will be made on the sanctions to be applied. The onsite inspection team may also be asked to resume its enquires if there is reason to believe there are further problems to be uncovered, e.g., in affiliate companies.</p> <p>A significant part of the problem resolution program involves meeting with the management, and, in particularly serious cases, the owners of the MC or SD to agree a remedial plan. The offsite department monitors the firm's implementation of the remedial measures. The objective is not solely to ensure that the changes have been made, but to assess whether or not the changes have achieved the required outcomes, e.g., in improving the treatment of clients. Inadequate outcomes will result in recommendations for further remedial work. Repeated failures could result in a license being revoked, as was the case with one SD in 2015. Issues with SDs arise less frequently in operational areas, but more frequently regarding the failure to maintain independence between the SD and its MC clients as required by the Investment Funds Law.</p>
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An important element of the meetings between CBR and the firm's management is to enable offsite supervision to make an assessment of the commitment of management to operating with effective RM policies and efficient internal controls and processes, and to consolidate this assessment with the analysis provided by the onsite team. The department has also begun a program of visits to MCs where, on a voluntary basis, these issues are analyzed and discussed. By visiting a mix of MCs with good processes and those with sub-standard processes, the department is able to develop a view on good (and bad) industry practice which guides its approach to risk assessment.

Based on the onsite and offsite analyses the department has divided the 45 largest MCs into categories using a standard traffic light approach (red, yellow, green). While no MCs are presently in the red zone, 30 are in yellow and 15 in green. AUM is not the sole criterion for this categorization. MCs in the green zone will be subject to an onsite inspection every three to four years. If an MC were to fall into the red zone, the department would increase the frequency and detail of reporting and use the CBR's powers to make an unlimited number of onsite visits and employ the resources of the inspectorate to assist in the resolution of the problem.

There is a focus on the most important institutions. There are three groups. Group one are managing asset of high net worth individuals. These are not open to the public and not that important unless big or pose systemic risks. The second group raises public funds but are small in value. The third group collects substantial funds from the general public. These are of greatest importance. The focus is on information from the last group. There is no formal risk assessment which takes account of quality of management. The proactive action on improving management set out above is currently applied only to the last group.

Most MCs are part of banking groups and the second largest is part of a foreign-owned banking group. Working relations with CBR's banking supervisors are good and if issues arise that require cooperation with an overseas supervisor the department looks to banking supervision to manage the process.

The department also handles 300 to 400 requests a quarter for clarification of how to comply with the complex mix of law, regulation, directions, etc. which is a feature of the Russian regulatory framework. The supervision and regulation teams seek to reach a consensus and to provide assistance to the enquirers. From the departments' perspective, commonality of enquiries gives an indication of particular industry-wide concerns where investigation might be warranted.

Onsite inspections

The procedure for conducting onsite inspections is prescribed in the CBR Regulation on April 24, 2014 № 151 "On the Procedure of inspections of non-credit financial institutions and self-regulatory organizations of non-credit financial institutions by authorized representatives of the CBR.

In the course of the inspection, officials of CBR have the right of unrestricted access to premises of organizations specified in Article 55.2.1.10 and to documents and information.

According to the 2014 annual report of CBR, in that year CBR departments actively collaborated to exercise supervision in the financial markets and the banking sector. As part of this collaboration, coordinated inspections were carried out at related credit institutions and NFEs. This collaboration specifically led to a more responsive and systematic approach to identifying risks for both credit institutions and NFEs. Moreover, to raise the quality of the inspection activity at CBR, an internal control system was put in place and special attention was paid to developing the information and analytical support offered to inspectors by implementing advanced information technologies.

During 2014–15 a major factor in the number of onsite inspection of MCs and SDs was the carrying out of a project to determine whether private pension funds satisfied the requirements for participation in the guarantee system for insured persons. In 2014, onsite inspections were carried out on 43 MCs and 11 SDs. In 2015 the numbers were 25 MCs and 5 SDs. As a result, the license of one SD was revoked. The usual number of planned onsite inspections is 6–7 for MCs and 2–3 for SDs annually.

Where an MC is a member of an SRO (currently optional: see Principle 9), the powers of the SRO are set out in Article 58 and are exercised alongside those of CBR. The SRO is entitled to:

- obtain information on the results of an examination and verification of activities of its members carried out in the manner established by CBR;
- monitor the observance of the rules and standards of the SRO by its members, in particular, by means of checking their activities;
- train individuals in the area of activities of MCs and SDs as well as, if a self-regulated organization is accredited with CBR, conduct qualification examinations and issue qualification certificates;
- apply, in compliance with the rules and standards of the SRO, sanctions and impose fines on its members if they breach the rules and standards; and
- file petitions with CBR for the issuance of licenses to members of the SRO.

Enforcement

Under Article 55.2.1.13 CBR is empowered to issue orders to be followed “without fail” by Cs, SDs, agents and registrars, to eliminate violations of requirements of the Investment Funds Law and regulatory acts of CBR and to prohibit the undertaking of operations.

Under Article 55.2.13.1 it may issue orders to be executed “without fail” to MCs and SDs to compensate for the actual damage caused to the unit holders if such damage has resulted from failure of the MC or SD to show proper attention to the interests of the unit holders.

Further powers of CBR:

- Under Article 55.2.14, CBR may make decisions suspending the allocation, redemption and exchange of investment shares;
- Under Article 55.2.15, file claims with a court for liquidation of legal entities exercising the activities specified in the Investment Funds Law without appropriate licenses and in other cases provided for by federal laws;
- Under Article 55.2.16, file claims with a court in the interests of stockholders of joint-stock investment funds and holders of units in UIFs in the event of breaches of their rights and legitimate interests provided for by the Investment Funds Law;
- Under Article 55.2.17, cancel qualification certificates in the event of repeated or gross violation by certified persons of requirements of the Investment Funds Law and of the legislation of the Russian Federation on securities;
- Under Article 55.2.18.1, appoint a provisional administrator; and
- Under Article 55.2.19, to exercise any other authority envisaged by law.

Sanctions applicable by CBR

Breaches of the Investment Funds Law or any other applicable regulatory instrument or act by a license holder may give rise to sanctions imposed by CBR. CBR has the power to prohibit the license holder from performing all or a part of its operations, to apply other penalties established by federal laws, or to terminate the license and assign a temporary administrator in cases provided for by the Investment Funds Law. (Article 61.1).

In extreme cases CBR may appoint an interim administrator using its powers under subsection 18.1, paragraph 2 of Article 55 of the Investment Funds Law. Grounds for appointment of an interim administration financial institution are established by Article 183.5 of the Federal Law of October 26, 2002 № 127-FZ "On Insolvency (Bankruptcy)."

The grounds are:

- repeated refusal within a month to satisfy the claims of creditors on monetary obligations;
- dereliction of duty to make mandatory payments in the period of more than ten working days from the date of the request;
- decision of a control body during field inspection to appoint an interim administrator for a financial institution to implement a solvency recovery plan, or the control over implementation of such a plan; and
- nonperformance or improper performance of a financial institution's plan to restore its solvency.

Governance of UIF management companies

As is the case elsewhere in the laws that CBR has the responsibility to enforce, the laws do not enable CBR to exercise discretion or give formal guidance as to what the standards of good governance in MCs or SDs should be, or what its expectations are in this regard. Instead, requirements of good governance are expressed implicitly in a series of specific prohibitions to be found at various points in the Investment Funds Law. These include prohibitions, restrictions, and requirements on an MC to manage (including, if appropriate, by disclosure) certain conduct likely to give rise to conflicts of interest between unit holders, the MC and its associates or connected parties. Also, the MC may not use the assets constituting the UIF to guarantee its own obligations unrelated to the fiduciary management of the fund (subparagraph 4 of paragraph 3 of Article 40 of the Investment Funds Law). Furthermore, the SD itself has a very heavy burden of responsibility under the Investments Funds Law to ensure that the MC follows the fund rules (as described in Principle 25).

The SD is required to be independent of the MC and can be considered the “responsible entity” as described by IOSCO.

The high level requirement on an MC as set out in paragraph 1 of Article 39 of the Investment Funds Law is that it acts reasonably and in good faith in exercising its rights and performing its duties for the benefit of unit holders. This provision, which is recorded in the fund rules, alongside the division of responsibilities between the MC and the SC are seen as the primary pillars of the protection of the rights of unit holders.

An additional element of external control over the activities of the MC is the requirement to have an annual audit (Article 49 of the Investment Funds Law).

The annual audit report is to cover:

- the financial statements of the MC;
- records and reporting in respect of the assets of the fund and transactions by the MC with those assets having regard to the legal requires on composition and structure of the assets;
- assessment of the estimated value of the fund;
- compliance with the custody requirement; and
- validation of the certification of investors’ rights to the assets in the fund, of property constituting the mutual fund, and documents certifying the rights to the property constituting the mutual investment fund.

This auditor's report is required to be attached to the financial statements of the MC. The auditor does not have an obligation to report deficiencies to CBR.

Measures aimed at preventing the misuse of insider information and price manipulation, must be specified as part of the quarterly and annual reports of the MC (Item 5.11 Regulation No. 04-5/ps) to CBR and unit holders.

Notifications and disclosure

An MC is required to report certain changes to CBR, such as changes to the fund rules. Such changes may not take place, at the earliest, until the changes have been registered by CBR. The MC is also obliged to forward to CBR a notice of changes in the composition of the board of directors (supervisory board) and executive bodies of the MC within five working days of the date of the events (Article 39.2.7).

An MC is required to publish notices of any change of its corporate name, location, telephone and fax numbers, email address, website address or new CEO. Also changes and additions to the rules for determining the NAV of a UIF sold to unqualified (retail) investors), are to be disclosed by the MC website no later than five working days before the date of these changes go into effect. (Direction of CBR from August 25, 2015 No. 3758-U" On the determination of the NAV of investment funds..."). Certain key changes such as to the manager's remuneration cannot come into effect until one month after the disclosure has been made.

There is no general and continuing obligation for the MC to report to CBR or investors, either prior to or after the event, any other information relating to material changes in its management or organization, or in the by-laws of the CIS operator. However, in practice the detailed reporting requirements of CBR as applied to the MC and SD, such as changes to the CEO, the SD, fund rules, and the asset valuation procedures, cover the necessary particulars.

Record keeping

Extensive requirements for record keeping and the responsibilities for particular original items (and copies) are contained in several legislative instruments.

Chapter IX of the Investment Funds Law sets out extensive record keeping requirements related to transactions in the assets of UIFs and transactions by investors in units of a UIF including both cash and securities elements. For example, Article 42.1 requires that the SD record the property making up a unit investment fund.

Under Article 42.4, CBR shall establish the rules for the recording and storing by the SD of the property provided for by Article 42 of the Investment Funds Law. Detailed and comprehensive requirements for record keeping and the responsibilities of the MC, SD, and registrar, respectively for particular original items (and copies) are contained in "Regulation on the activities of specialized depositaries" No. 474-P, Regulation No. 04-5/ps and Order of FFMS of Russia April 15, 2008 No. 08-17/pz-n.

Under Article 42.5, in the event of failure to discharge or improper discharge by the SD of its duties related to recording and custody of the assets making up a UIF, the specialized depository shall be jointly liable with the MC to the owners of shares/units of the unit investment fund.

Conflicts of Interest and operational conduct

Subparagraph 2 of paragraph 2 of Article 55 of the Investment Funds Law No. 156-FZ gives CBR authority to establish requirements aimed at preventing conflicts of interest at management companies, specialized depositories and shareholders of joint stock investment funds (investment unit holders).

The Investment Funds Law specifies the main requirements for the operation of CIS in Russia, including the procedures for making investments. Resolution of the Government of the Russian Federation from July 25, 2002 No. 564, July 15, 2013 No. 600, August 27, 2002 No. 633, September 18, 2002 No. 684), provides that the MC should act reasonably and in good faith for the benefit of holders of investment units.

Measures aimed at preventing conflicts of interest in MCs and SDs include the requirement to appoint a controller or an internal control unit who reports directly to the supervisory board and is a position which cannot be filled by the CEO. Employees of the MC must notify the controller of any conflict of interest, while measures aimed at preventing conflicts of interest must be specified as part of the quarterly and annual report of the executive of an MC to the supervisory board. (Item 5.11 Provision № 04-5 /ps).

The Investment Funds Law (item 9 paragraph 1 of Article 40) contains restrictions on transactions involving acquisitions of property belonging to the MC, its participants, and related parties the primary and predominant business companies party, its subsidiaries and affiliates or by the disposal of assets to such persons. The restriction does not apply to transactions on the exchange of investment units and transactions which are made on a stock exchange on the basis of fair bidding and best prices, and where trading is carried on anonymously. As regards certain specific activities in the trading of securities on behalf of a UIF, for which IOSCO expects to see specific regulatory controls:

- best execution is dealt with only in the overarching requirement to act reasonably and in good faith for the benefit of holders of investment units;
- appropriate trading and timely allocation of transactions is dealt with by requiring that the MC must declare to its broker or dealer the fund for which the trade is being executed when giving the order and that funds name is entered onto the order. According to CBR this should prevent the MC allocating after the trade and perhaps favoring one fund over another;
- churning is not specifically prohibited but the requirement of Article 17 of the Investment Funds Law on the need to specify in the fund rules the overall size of

permitted expenses, which includes broker commissions for transactions, should prevent trading to generate large amounts of commission for a broker above the maximum expenses amount. A second line of defense is the obligation of the SD to inform CBR of suspected violations of the fund rules by the MC although it is not clear if SD's appreciate what constitute the offense;

- related party transactions are fully covered;
- an MC is not permitted to be an underwriter except for a rights offering on an existing UIF holding; and
- the exercise of due diligence in the selection of investments is considered implicitly and only in the obligations to act fairly and to stay within the asset composition and structure.

As noted above under "churning" disclosure of fees and expenses is dealt with in the law that provides that the amount of remuneration and a list of expenses (regulated by Direction of CBR 3506-V), as well as their size must be specified in the fund rules. Costs and fees in excess of the amounts specified in the rules are to be paid by the MC at its own expense. CBR has not seen the practice of soft commissions in the market, and so a regulation is not yet necessary.

Delegation

Only limited delegation by an MC is permitted, such as the acceptance of applications for purchase or redemption of shares to the agent and to a broker for execution of transactions. Thus, the transformation of the MC in an empty box (a meaningless shell) is not possible. The MC remains responsible for the actions of its delegates as is consistent with international standards.

There is no specific requirement that an MC has adequate capacity and resources and to have in place suitable processes to monitor the activity of the delegate and evaluate the performance of the delegate although given that the MC remains responsible for any failure of a delegate, commercial necessity should motivate an MC to continuously satisfy itself as to the performance of the delegate's operations.

Although a MC should be able to terminate the delegation and make alternative arrangements, where the delegate is an affiliate company, such as a broker in the same banking group, that may, in practice, be more a theoretical than a practical requirement given normal intra-group managerial pressures to keep trading "in-house."

There are no specific requirements for disclosure to investors in relation to the delegation arrangements and the identity of the delegates.

If CBR becomes aware that delegation arrangements have given rise to a conflict of interest between the delegate and unit holders, CBR has the right to ban the arrangement on the

	<p>grounds that it threaten the rights and legitimate interests of unit holders of investment units (item 9 paragraph 2 of Article 61.1 of the Law No. 156-FZ).</p> <p><i>International cooperation</i></p> <p>This issue is not significant in Russia. The only foreign funds that may be advertised are those listed on a Russian Stock Exchange. Currently there is only one and its AUM totals only US\$20 million. Russian funds cannot have a SD outside Russia. Both the MC and SD have to be resident in Russia, although the depository can use a sub-custodian for foreign securities e.g., Eurobonds. A foreign fund could be sold to qualified investors but only through private placement, via a broker. CBR's international cooperation is governed by provisions of Central Bank Law. It is a signatory to the IOSCO MMoU.</p>
Assessment	Partly implemented
Comments	<p>The downgrade results primarily from deficiencies in three areas.</p> <p>The first is the absence of an obligation to obtain the best price when buying or selling securities for the fund (a "best execution" rule). This is particularly relevant when the MC is dealing directly in the OTC market or as an identified counterparty in the MOEX bilateral market but is also relevant when an MC uses a broker. Even when most orders are executed in the MOEX limit order book, the way a broker handles the order can have a significant impact on the price at which the trade is executed and an impact on the value of the acquired shares or remaining shares resulting from the trade and its publication by the exchange.</p> <p>The second reason is the absence of a regulation which requires a MC to exercise due diligence in the selection of securities to buy or sell. Due diligence is about the careful selection of securities even within the asset composition and structure. Both regulations are more rigorous and targeted than the obligation to act in the client's best interests.</p> <p>The third arises from the issue highlighted in Principle 29 (licensing of market intermediaries). The criteria for individuals that disqualify them from becoming board members or senior managers of an applicant for a company license, while useful, do not provide for a full test of the integrity of the individuals concerned. This is also a weakness in the licensing of MCs and contributes to the rating. In order to make a fully informed judgment on fit and proper as to whether to grant a license to an applicant, the assessors suggest that several other factors should be taken into consideration by CBR, although none necessarily should result in an automatic bar. These might include such matters as the personal bankruptcy of the individual, or an adverse finding by a professional organization or SRO. Under the current law, administrative disqualifications are disregarded after they have been completed, regardless of the seriousness of the incident that led to the disqualification. There is no reference in the statutory tests to the implications of employment termination by a previous employer. The test as regards the criminal convictions applies only to unexpunged economic crimes (however serious) and not to other crimes (again, however serious).</p>

Although churning is probably caught by the limit on expenses CBR should examine whether the SDs are adequately informed to recognize churning since it may be possible even within the overall fees limit.

Although the rule on allocation of trades deals with post-trade allocation, the IOSCO requirement seeks to prevent an abuse whereby limited “good deals” are available and would be suitable for more than just one fund, but are always allocated to preferred funds (e.g., a new fund being heavily promoted). Investment opportunities are supposed to be allocated fairly across the suitable funds and not all to one, as this would permit. CBR advised that this is not an issue currently, as MCs are unlikely to have more than one fund which could take the same securities. While that may be the case, it may become relevant in the future as the CIS market expands.

Given the limited scope for delegation described above, the absence of a specific requirement for disclosure to investors in relation to the delegation arrangements and the identity of the delegates is not significant. It should be kept under review if that scope is expanded in the future.

Although the emphasis in the law and in CBR supervision on technical resources, RM and internal controls in the SD, as described in Principle 25, is currently sufficient, CBR should consider the case for placing greater supervisory emphasis on the internal controls in the SD as it is failure within the SD that may expose investors to material risks. For example, they may suffer losses from inadequate segregation of the assets of a UIF, possible misuse of those assets by the depository or the MC, pricing errors, and delays or other problems in the redemption process.

Furthermore, RM and internal controls within fund management companies globally has been given increased focus following the financial crisis. This can be seen in the work of the FSB on shadow banking, IOSCO’s standard setting in areas such as liquidity RM, and the current debate on whether certain investment funds and their management companies should be supervised as Systemically Important Financial Institutions (SIFIs).

CBR’s current work on developing more rigorous capital requirements for MCs, with a greater focus on the need to hold liquid assets, is to be welcomed.

Although the Investment Funds Law and associated regulatory acts of CBR set out a number of prohibitions and structural requirements intended to manage and diminish conflicts of interest, the list of actions which must be taken, gives rise to gaps which can result in certain conflicts not being addressed by MCs because the law and regulation is silent on them. For example, while conflicts between the MC and its clients are covered, there appears to be no requirement to properly manage and mitigate conflicts between clients. In a UIF such conflicts may arise in a stressed market when redemption requests surge and there is a need to sell assets to meet them. Although the urgency of the situation might suggest to the MC that the proper solution

	<p>is to sell the highest quality, most liquid assets first, that will advantage the exiting unit holders and disadvantage those who have chosen to remain invested.</p> <p>The process of assessing the risk inherent in individual MCs, assigning them to particular “buckets” and using those assessment as the basis for the intensity of supervision appears to be well thought out, established and operated, and fully consistent with good international standards for risk-based supervision. In conducting onsite inspections there appears to be an emphasis on identifying clients who may be carrying out improper transactions, with or without the informed assistance of the firm. While that is a necessary part of the regime, inspectors should be equally engaged in seeking evidence of a firm treating its clients unfairly, by selling funds or other products not suitable for the client’s risk profile or where a less expensive (but lower commission generating product) would meet the client’s need equally well or even better. As retail participation in financial markets increases, product misselling is likely to increase and this will damage the confidence of new investors. Furthermore, the usual annual number of planned onsite inspections (6–7 for MCs and 2–3 for SDs) is insufficient. This comment is equally relevant to the onsite inspection of market intermediaries.</p>
<p>Principle 25</p>	<p>The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</p>
<p>Description</p>	<p>Legal form/investors’ rights</p> <p>Federal Law No. 156-FZ of November 29, 2001, “On Investment Funds” codifies the legal form of an investment fund, MC and SD and establishes basic provisions with respect to disclosure, extent of information disclosed, procedures for the disclosure and presentation of information, and principles for the protection of the rights of investors in the funds. As described in Principle 24 there are two legal forms of investment funds: joint stock funds and UIFs. As referenced in IOSCO’s June 2006 report Examination of Governance for Collective Investment Schemes they correspond to the “corporate model” and the “contractual model.” The primary product for retail investors is the open-ended UIF. The following description of governance and investor rights deals primarily with these funds although the regulation is broadly similar for all types and sub-types of funds.</p> <p>Each fund is required to register its rules with CBR. These rules, in effect, constitute the prospectus or offer document of the fund and are given to investors. Model Rules for various types of funds including UIFs have been established by the Resolution of the Government of the Russian Federation:</p> <ul style="list-style-type: none"> • from August 27, 2002 No. 633 "About the Model Rules of the open-end investment fund"; • from September 18, 2002 No. 684 "About the Model Rules of the interval unit investment fund";

- from July 15, 2013 No. 600 "On Approval of the Model Rules of trust management of the exchange unit investment fund"; and
- from July 25, 2002 No. 564 "About the Model Rules of trust management of a closed mutual investment fund."

These include information on the terms and conditions of the trust arrangements, structure of the funds (open, interval, closed or exchange traded), the composition of the assets, and risk disclosures. They may not contain unfair, unethical, false, hidden or misleading information. The use of the Model Rules is mandatory although the MC has discretion on the terminology used, e.g., in the statement of the fund's investment policy and the description of the risks inherent in the fund.

CBR is responsible for ensuring that the legal requirements as to form and structure are observed, particularly when the fund is set up. The fund rules must be registered with CBR that checks their correctness and completeness before a fund can be marketed. Under Article 10 of the Investment Funds Law, CBR has powers to demand restatements and prohibit disclosure. On a day-to-day basis at an operational level the SD is responsible for ensuring that the terms of the rules are complied with by the MC and must notify CBR of any violations.

Under Article 20 (Entry into Force of Amendments and Addenda to be Made to the Trust Administration Rules of a Unit Investment Trust) amendments and addenda to be made to the fund rules of a UIF shall enter into force as of the date of disclosure of a notice of their registration with CBR except for certain amendments of particular importance to investors.

These are:

- alteration to the investment declaration (the investment policy of the fund);
- alteration of the type of a unit investment trust; and
- an increase in the rate of remuneration for a MC or specialized custodian, (including discounts to be charged on redemption).

In these cases, the amendments and addenda to be made to the fund rules enters into force in respect of open, exchange and closed UIFs one month after the date of disclosing a notice of registration of such amendments and addenda. Unit holders are thus given ample time to make a decision on whether to remain in the fund or to redeem their units.

As noted above, amendments to the fund rules must be registered with CBR before they become effective. Separately, an MC must also send to CBR a notice of changes in the composition of the board of directors (supervisory board) and executive bodies of the MC within five working days of the changes (Article 39). Article 54 sets out the general obligation on the MC and the SD to file reports with CBR. CBR operates a schedule for such reports with submission deadlines. CBR believes that this regime is likely to achieve the outcome that IOSCO requires as regards material change reporting to CBR although there is no general obligation to notify CBR of all material changes.

	<p>Separation of assets/safekeeping</p> <p>All assets of a UIF must be completely segregated from the assets of the MC and the SD. When assets are held by a sub custodian, the specialized depository retains responsibility for the assets.</p> <p>There were 39 SDs in February 2016. One SD license was revoked in 2015.</p> <p>A UIF can have only one SD. Under Article 42 of the Investment Funds Law, the property making up a UIF must be recorded and be held in the safekeeping of a SD except as otherwise required for specific types of property (such as real estate). The SD is not entitled to use and dispose of the property making up a UIF. Rights to securities making up the property of an investment trust must be recorded on a custodial account in the SD</p> <p>Article 44.6 sets out provisions intended to secure the independence of the SD from the MC, one cannot be a subsidiary of another. However, they can both be members of the same group. The SD cannot itself own shares in the UIF for which it is the SD. Article 44.7 sets out limits to other activities of an SD. For example, a SD can be a credit institution but cannot be a registrar except where it acts as a registrar for a stock exchange.</p> <p>The operations of the depository are subject to extensive, detailed requirements by CBR Regulation No. 474-P of June 10, 2015 "On the activity of specialized depositories." This regulation covers:</p> <ul style="list-style-type: none"> • The form of accounting system to be established (which must be capable of being sorted and sampled with a view to finding discrepancies) and the procedures for operating it; • The reports the system must be capable of generating; • The procedures by which the SD must perform its functions; • The contents of the operational rulebook of the SD; • Requirements to notify CBR of infringements and discrepancies and their elimination (or otherwise); • Disclosure of significant shareholders and other controllers of the SD; • The mechanism for transfer of fund assets to another SD; and • The mechanism for appointment by the SD of a replacement MC should that be necessary. <p>Generally, the SD is responsible for losses arising in the course of the performance of its functions. However, there are exemptions when the SD employs certain sub-custodians (such as the Russian CSD and certain foreign depositories) included in a list maintained by CBR under</p>
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	<p>Item 4 of Article 25 of the Federal Law No. 414-FZ of December 7, 2011 "On the Central Depository."</p> <p>MC insolvency</p> <p>Chapter V of the Investment Funds Law sets out the processes to be followed in the winding up of an MC. It establishes who is responsible for managing the process, which may be the SD or a provisional administrator, and sets out detailed requirement that they must carry out. It also sets out the supervisory powers of CBR over the process and the persons responsible.</p> <p>Under Article 39 the decision on voluntary liquidation of the MC cannot be accepted prior to the termination of all the funds for which it is the MC, and until all the rights and obligations attached to those assets have been transferred to another MC. Funds in an account pending investment or pending disbursement are specifically protected in the event of a MC bankruptcy (Article 13.2).</p> <p>This topic is discussed further in Principle 27.</p>
Assessment	Fully Implemented
Comments	<p>The regulatory system places onerous obligations on SDs to ensure that a UIF is managed solely in the interests of unit holders. This includes agreeing with the MC the price at which securities in the fund are bought or sold and the value of the securities for determining the NAV of the fund units. Although an SD must be a separate legal entity from the MC, it is able to be a company within the same group as the MC. This does not amount to full independence in law or fact. There is a potential in these circumstances, despite the current regulation of the activities of SDs, for collusion to occur. A mechanism to mitigate this risk might be to assign a High Risk or "red zone" rating to SDs in this position and submit them to the highest intensity of SD supervision. Alternatively, the Investment Funds Law could be amended to secure actual independence of the SD.</p>
Principle 26	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	<p>The Investment Funds law and an Order of the FSFM No. 05-23/pz -n of June 22, 2005, "On Approving the Regulation on Requirements for the Procedures and Times of Disclosure of Information Related to the Operation of Joint-Stock Investment Funds and Management Companies of Mutual Funds, and for the Content of Disclosed Information" are the primary sources of the regulation of disclosure. There are limited exemptions for sales to qualified investors.</p> <p>The general obligation is that all information required by the law or regulatory acts of CBR must be published on a MCs internet site on a timely basis. As noted in Principle 25, Article 20 sets out material changes which do not enter into force until one month after the date of disclosing a notice of registration of such amendments and addenda. Unit holders are thus</p>

given ample time to make a decision on whether to remain in the fund or to redeem their units. There is however no general obligation to disclose all matters material to the valuation of the fund on a timely basis such as changes in the risk profile of the fund from changes in market or economic conditions. Nor is there a general disclosure obligation to provide sufficient information to allow investors, and potential investors, to evaluate the suitability of the CIS for them.

There is however (Article 51.7) a long list of prohibited disclosures such as:

- unfair, unreliable, unethical, deliberately false, concealed or misleading information;
- any guarantees and promises of would-be effectiveness and yield level in particular, those based on their actual past performance;
- information having no direct relation to the joint-stock investment fund, the MC of the UIF or the UIF itself;
- references to approval or endorsement by the state authorities of any information on the activities on the joint-stock investment fund or the MC of the UIF;
- false or improperly formulated statements or assertions on factors significantly affecting the results of the fund, in particular, supported by documents but relating to some other period of time or event;
- statements or assertions on a change or other comparisons of the results of the fund not based on the yield calculations made in compliance with regulatory acts of CBR;
- overstated or unsubstantiated statements on the managerial skills of the MC staff and also on their connections with the state authorities and local self-government bodies; and
- statements to the effect that the results of activities of the joint-stock investment fund and the MC of the UIF that have been attained before can be repeated in the future.

CBR has the right to:

- demand the retraction of disseminated, supplied or disclosed information which does not satisfy the requirements of the Investment Funds Law or regulatory acts of CBR, as well as to demand dissemination, or disclosure of corrected information; and
- prohibit dissemination, supply or disclosure of non-compliant information.

Upon detection of false or misleading information in the fund rules, CBR sends the MC its conclusions. If within 25 working days the violations are not corrected, CBR has the right to refuse to register the rules or changes and additions to them. CBR also has the right to demand correction of false, inaccurate or misleading information (paragraph 10 of Article 51 of the Investment Funds Law).

	<p>Paragraph 9 of Article 51 of the Investment Funds Law requires a MC to present all information, including advertisements, to CBR for approval.</p> <p>There is no requirement to present the information in easy to understand language. While the Model Rules (which are mandatory), help to some extent in facilitating comparisons between funds by requiring information to be set out in a standard format, the legal system requires that the parts concerning the rights of the investor must be copied from the law (which is not expressed in simple, straightforward terms) and these cannot be changed without, it is argued, changing the meaning of the law. CBR is studying whether despite this constraint, some improvements can be made to assist the understanding of retail investors.</p> <p>IOSCO has itemized a list of specific information that should be in the offering document, or, in the case of Russia, in the registered model fund rules. The disclosure requirements of CBR cover most of these requirements. Although there is no requirement to disclose information on delegated activities, as noted in Principle 25, the scope for delegation is very limited under the law and the MC remains responsible. This omission is not significant.</p> <p>Fund rules must be kept current as it is not possible to change the activities of the MC until the changes have been registered at CBR.</p> <p>Specifically, for financial reporting, a MC is required to publish a range of reports on its financial condition and the condition of funds it manages in accordance with a schedule set by CBR. These include monthly, quarterly, and annual reports. Timings, of 15, 30, and 120 days (or before the AGM in the last case) are consistent with general international practice although some countries do better and there is a general move to reduce publication times in order to make the information more useful to investors. CBR also has this issue under consideration.</p>
Assessment	Not Implemented
Comments	<p>The downgrade arises from four issues, although three are closely connected, that is the absence of a general obligation to disclose relevant matters.</p> <p>The absence of general requirements on fund management companies to disclose to investors and potential investors all matters material to the valuation of a fund (KQ1).</p> <p>The absence of a general disclosure obligation to provide sufficient information to allow investors, and potential investors to evaluate the suitability of the fund for that investor or potential investor (KQ4).</p> <p>The absence of a general obligation to keep the fund rules up to date to take account of any material changes affecting the fund (KQ8).</p> <p>The fourth reason is the lack of a requirement that the material matters be disclosed to investors and potential investors in an easy to understand format and language having regard to the type of investor (KQ2). Some jurisdictions achieve this by requiring MCs to</p>

	publish a so called “key features” document to accompany a full prospectus or offering document which contains enough information about the nature and complexity of the fund, how it works, any limitations that apply, and the material benefits and risks of investing in the units for a typical retail investor to be able to make an informed decision.
Principle 27	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>Valuation</p> <p>The requirements for the valuation of the assets of a UIF are found in Chapter VII of the Federal Law of November 29, 2001 156- FZ “On Investment Funds” and CBR Direction of August 25, 2015 No. 3758-D “On determination of NAV for investment funds.” According to Direction of August 25, 2015 No. 3758-D the assets’ values and the amount of liabilities shall be estimated at fair value according to the IFRS 13 “Fair Value Measurement.” The detailed methodology, and any changes or additions to it, must be agreed by the CEOs of the MC and SD (Direction 1.16). It is not set out in the fund rules but must be on the website of the MC and be sent to CBR.</p> <p>Any changes or additions must be notified to CBR within two days of their being made. An explanation of the reasons for introducing changes in and additions to the rules for estimating the NAV must be attached to such changes and additions. (Direction 1.22).</p> <p>Direction 1.17 sets out a non-exhaustive but detailed list of components which must be included in the methodology for estimating the value of assets, including the procedure for the recognition of the markets as active, the criteria of the choice of ways and models of estimating the value depending on kinds of assets, and the frequency of making such estimations. Under Direction 1.10, the value of the net assets of an open-ended UIF is to be determined on daily. For a closed-ended UIF, NAV must be determined monthly. Under Direction 2.2 the NAV of a unit is to be calculated by dividing the total NAV of the UIF by the number of units held by registered owners.</p> <p>The use of IFRS 13 requires the MC and SD to agree on the inputs to be used based on a three level hierarchy for fair value; that is:</p> <ul style="list-style-type: none"> • Level 1 when reliable quoted prices in an active market for the asset are available; • Level 2 where, for example, a quoted price in an active market is not available but a reliable yield curve for the asset (e.g., government bonds) is directly applicable or by correlation; and • Level 3 where the inputs are unobservable but may be inferred from various sources including the MC’s and SD’s own data and reasonable assumptions about market participants’ behavior.

The use of IFRS 13 also requires the MC and SD to agree to follow IFRS guidance on measurement and to agree on the valuation techniques to be employed in valuing assets consistently on a daily basis. Where valuation is dependent on the use of a pricing model (Level 2 and 3 above), the MC and the SD have to use the same model and the same inputs.

Under Direction 1.18 where a MC has the same assets in more than one fund it has to use the same methodology for valuing the assets in each fund, although in practice the small size of the funds market makes this occurrence a rarity.

Each time an asset is valued, the MC and the SD must agree.

They each calculate the value. If they agree, this is published. If the SD reaches a different conclusion and they cannot agree, the SD reports this failure to agree to CBR.

CBR recognizes that an MC or individual employees such as a trader may from time to time have an incentive to incorrectly value an asset when reliable prices in an active market are not available but believes that the requirement to agree the valuation with the SD minimizes the risk of this occurring. While it is possible that an individual at the MC could collude with an individual at the SD, this is presumed to be highly unlikely as the business of one MC is not likely to be significant to an SD, which also has significant potential civil liability if it approves erroneous prices.

Further assurance as to the integrity of the valuation process is provided by the requirement that an external auditor values each fund on an annual basis. CBR understands that this will normally be on a random sampling basis.

Pricing and redemption issues

Open UIFs must be valued on a daily basis and the unit NAV must be published on the MC's website on the next day according to paragraph 3.20 of FSFM decree of June 22, 2005 No. 05-23/pz-n.

Pricing errors

An MC is legally required to correct pricing errors subject to a de minimis exemption (0.1 percent). (Direction 1.12).

Redemptions

There are detailed rules for the redemption of units in a UIF set out in Chapter IV of the Investment Funds Law. Article 24 states that redemption applications relating to an open UIF must be accepted every business day. Payment of proceeds is governed by the fund rules but can be no longer than 10 days after completion of the necessary bookkeeping procedures following receipt of the redemption application (Article 25.2). (See also the discussion under

Suspensions below.) Redemption rules must be part of the fund rules that are registered with CBR and made available to investors.

Under regulation 22-ps the MC has four options. It must either sell assets to meet redemptions, redeem units out of its own resources, borrow funds (with a limit of 10 percent of the NAV) or repo sufficient assets to meet redemptions. Under Article 23.4 4 the acceptance within one working day of applications for redemption of 75 percent or more of units in an open UIF is grounds for termination of the trust.

Under Article 26.7 the fund rules of a UIF may provide for a discount on the estimated value of units when redeemed. The maximum rate of discount may not exceed 3 percent of the estimated value of the units. The discount goes to the benefit of investors who remain. Under Direction of August 25m 2015 No. 3758-D Article 1.13 data supporting the calculation of redemption values must be kept for at least three years from the date of the relevant calculation. Should a customer complain to CBR about the redemption price provided, CBR may investigate.

Suspensions of redemptions

Article 29 of the Investment Funds Law states: The redemption and exchange of units may be suspended by the MC only if allocation of units is suspended at the same time.

The allocation, redemption and exchange of investment shares may be simultaneously suspended only in the following cases:

- it is impossible to assess the value of the UIF's units for reasons which are beyond the control of the MC; or
- the NAV of the fund had declined by more than 10 percent over a three-day period; and only if the MC judges that it is the best interests of unit holders that redemptions be suspended.

An MC is required publish a statement on the suspension stating its reasons for suspending redemptions. Article 29. 2 states: In the event of a simultaneous suspension of allocation, redemption and exchange of investment shares, the MC is obliged to notify CBR in writing on the same day specifying the reasons for the suspension. It is also required to provide CBR with at least daily updates of the position.

If CBR believes that the MC is failing to honor redemptions or is improperly imposing a suspension of redemptions, CBR has the right to suspend all or part of an MC's operations or terminate the license and appoint a temporary administrator (Article 61.1 Investment Funds Law).

Under the law, in normal circumstances, an MC has three days to manage the bookkeeping, etc., on receipt of a redemption request (although that period can be shorter if the fund rules

	<p>so provide). The price the unit holder receives is not the price on the day he makes the redemption request but the day the bookkeeping is completed. The MC then has a further 10 days to pay the unit holder the proceeds of sale. In the instance of a surge in redemptions, this provides the MC with a certain “breathing space” to try and resolve the problem. Effectively, it is not until 13 days have passed that the initial moves to wind up the fund need to be made. There are provisions for an orderly winding up of a UIF as set out in Principle 25.</p>
Assessment	Fully Implemented
Comments	<p>The requirement on the MC and SD of a UIF to agree on the detailed methodology to be used for valuing the assets of the fund (as permitted by IFRS 13), and the obligation to use the methodology on a daily basis when pricing securities minimizes the risk of the MC, or individual employees, mis-valuing positions to give a false and misleading impression of the value of the fund when active market prices are not available.</p> <p>Should an MC not be able to meet redemptions due to a spike in request to redeem, the law and regulation lay down strict parameters to govern the MC’s actions. The normal procedures of pricing, processing, and paying provide some flexibility on the first point and a two-week window on the second, which may enable the MC to meet his obligations to unit holders, thereby, avoiding having to move to a formal winding up of the fund as provided under the law. Unit holder’s cash and their rights to the securities in the fund appear to be properly protected.</p> <p>There has not been a failure of a fund for a long time, and the relevant laws and regulatory acts have changed, some repeatedly, in recent years. CBR might wish to consider running an exercise (a “war game”) to test the current legal and operational position against a hypothetical failure of a fund or group of funds.</p>
Principle 28	Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight
Description	<p>According to FSFM decree of December 28, 2010 No. 10-79/pz-n “On provision approval on asset composition and profile of joint stock investment funds and mutual investment funds,” hedge-funds are defined as one kind of joint stock investment fund or closed-end, interval UIF the shares of which are restricted. Moreover, there are some certain restrictions on asset composition and profile for such kind of investment fund. Overall, the regulation of hedge-funds is very similar to the regulation of ordinary investment funds. The MC, SD, and registrar are licensed by CBR and hedge fund rules are registered with CBR in the normal way. CBR has the same authority to obtain information from these funds as for other investment funds.</p> <p>Funds which meet the definition of hedge funds can be sold only to qualified investors (institutional and high net worth and experienced individuals) and this the supervision of hedge funds does not meet the IOSCO requirements that “because of the risks involved” hedge funds should be subject to more intensive supervision irrespective of their clients’ competence.</p>

	<p>Currently, hedge funds do not pose a systemic risk to the Russian Federation. The total amount of AUM by hedge funds in the Russian Federation at the end of 2015 amounted to only US\$1.1 billion, which is insignificant in terms of the impact on the stability of the financial system. It is believed that Russian investors interested in these products are most likely to have assets outside of the Russian Federation and invest in these funds when abroad.</p> <p>In one area of regulation, funds of this nature, unlike open UIFs, can borrow to invest without limitation. Should they develop a significant market share this leverage element might, in time, become a significant source of systemic risk. But there is no indication of that as a progressing trend in early 2016.</p>
Assessment	Broadly implemented
Comments	<p>Hedge funds are not a source of potential or actual systemic risk in the Russian Federation and as such intensive regulation as set out in the Key Questions to this principle is not required. Furthermore, hedge funds and hedge funds managers are regulated at the same level as other funds targeted at qualified investors. The further development of hedge funds, and funds which, while not being formally categorized as hedge funds, can borrow to invest and thus can be highly leveraged, should be closely monitored by CBR with a view to subjecting them to more intensive supervision should they begin to demonstrate systemic risk characteristics.</p>
Principles for Market Intermediaries	
Principle 29	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>The scope of the licensing requirement</p> <p>The Securities Law prohibits any person from conducting the business of a professional securities market firm unless they have a license from CBR (Article 51(6)). The activities that are licensed are brokers, dealers, investment managers, custodians, and registrars (Articles 3-8). These are collectively known as professional securities market firms.</p> <p>Functionaries of CIS (management companies and specialized depositories) are covered by the Investment Funds Law and the regulation is described under Principles 24 to 28.</p> <p>There is no requirement for investment advisers to be licensed (whether advising on individual portfolios or on corporate securities transactions). However, investment advisers who deal on behalf of customers or who hold their assets would be caught by the definition of an investment manager and would have to be licensed as such (Article 5 of the Securities Law). The provisions regarding the segregation of client assets, capital, and organizational requirements, record keeping, disclosure, and conflicts of interest would apply in the same way. Where brokers give advice (as in, make investment recommendations for their clients), there are no explicit provisions relating to suitability of advice or the creation of an investment profile. Moreover, in such cases, there would be only limited effective rules on conflicts of interest (discussed in Principle 31).</p>

There is no direct requirement for licensing underwriters. However, CBR advise that underwriting activity would be covered by the definition of broking and dealing activity. Regulation 428 of August 11, 2014 on the issuance of securities (the Issuance Regulation) contains provisions on brokers who guarantee to buy securities that are not bought by the public following a public offer (paragraph 23.7) and this confirms the view of CBR that underwriting should be considered an aspect of broking and dealing.

Licensing authority of CBR

CBR is the licensing authority. Article 39(1) of the Securities Law states that the securities activities covered by the law are exercised on the basis of a license issued by CBR. The Securities Law does not state explicitly that CBR has the power to refuse a license to an applicant if the criteria for licensing are not met. This is in contrast for the provisions for the granting of permits to SROs (Article 50) and the granting of licenses to functionaries of investment funds (Article 42(15) of the Investment Funds Law), where there is a direct reference to the right of CBR to grant or refuse to issue a license. The absence of such a provision in the Securities Law with respect to professional securities markets firms does not appear to have any practical effect since the right to refuse can be inferred from other provisions. Instruction 168 of September 11, 2015 on licensing (the Licensing Instruction) gives specific grounds for refusing a license, which are discussed below.

CBR has no power to impose a license condition.

The licensing criteria

For professional securities market firms, the law, and regulations establish minimum criteria relating to integrity, financial standing, and capital as follows:

Integrity

Articles 10.1 and 10.1.2 of the Securities Law apply a basic integrity test for the specified senior officials and owners of more than 10 percent of the equity of securities firms. No one, with an unexpunged⁸ conviction for an economic crime can hold one of the specified positions or hold more than 10 percent of the shares in a professional securities firm.

Article 10.1 of the Securities Law sets out an added test for specified senior officials that they must not have been the subject of an administrative disqualification that is still in force. It also provides that the CEO of a securities firm must not have held a senior position of control of a regulated financial organization whose license was cancelled or suspended within the last three years.

⁸ There is provision in the law for certain economic crimes to be expunged from the record after a specified period of time.

	<p>There are no other integrity tests beyond these specific items.</p> <p>Anyone being caught by these matters is automatically disqualified, with no discretion being granted by CBR to consider the seriousness of the matter or the relevance to the position being taken up. Further integrity tests relating to bankruptcy are under consideration, along with a more general test related to business reputation but this is not yet finalized.</p> <p>Financial Standing</p> <p>Regulation 481 of July 27, 2015 on licensing (the Licensing Regulation) imposes capital requirements (paragraph 2.1.1). The calculation method is defined in FSFR Order 8-41/pz-n of October 23, 2008. Direction 3329 of July 21, 2014 (the Own Funds Direction) specifies the capital requirement that applies to brokers, dealers, investment managers, custodians and registrars. There is no capital requirement imposed under securities legislation for professional securities markets firms that are also banks because their capital requirements are established by other regulatory acts tailored to the circumstances of banks. The adequacy of these requirements is considered in the context of Principle 30).</p> <p>There are no requirements relating to the financial standing of owners or senior management officials of a license applicants.</p> <p>Competence</p> <p>Regulation 10-4 PZ-N of January 28, 2010 (the Qualification Regulation) describes the qualification certificates that must be held by the chief executive, compliance officer, and various other key office holders and these are imposed by the Licensing Regulation (paragraph 2.1.4). The qualification certificate can be obtained if the person concerned has a specified higher education qualification, relevant work experience, and has passed the relevant examination (specified by CBR and with a syllabus specified by CBR). There is no requirement for the higher education to be in a relevant area. The work experience must have been in a financial organization but there is no requirement that such an organization must have been of a similar kind to that for which the new position is sought. The work experience of CEO of a small, one-person forex dealer of sufficient length would meet the work experience requirement for the CEO of a broker/dealer, for example.</p> <p>The Licensing Regulation also states that a license applicant must have specialists in the field of activity it expects to undertake (paragraph 2.2.2).</p> <p>There are further requirements as to the capacity of the applicant to undertake business:</p> <ul style="list-style-type: none"> • Article 10.1.1 of the Securities Law imposes an obligation to appoint a compliance officer and create a RM department. The Licensing Regulation also states that a CEO and compliance officer must be appointed (paragraphs 2.1.2 and 2.1.3) and adds a requirement for a finance director (internal accounting specialist) (paragraph 2.2).
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- The Licensing Regulation imposes further requirements on the applicant, including a physical address, IT infrastructure (paragraphs 2.1.5—2.1.7), and a two-year business plan (paragraph 2.1.8) which demonstrates viability.
- Article 10.1.1 of the Securities Law also obliges a professional securities firm to have adequate internal controls. The Licensing Instruction requires an applicant to supply a statement of internal controls, a list of measures to reduce conflicts of interest, and a list of risk mitigation measures (paragraphs 2.1.29–2.1.31). FSFR Order 12–32 of May 24, 2012 (the Internal Controls Regulation) also obliges a professional securities firm to appoint a compliance officer. It includes a requirement to have internal controls on AML defenses and Insider Dealing (paragraphs 1.2 and 1.3).
- Where securities firms combine more than one field of activity, they must conform to certain organizational requirements that include the creation of separate structural units (paragraph 2.3.1 of the Licensing Regulation) together with measures to address the conflicts of interest arising (paragraph 1.5).

There are no more general criteria relating to the overall capacity of the license applicant or its willingness and ability to conduct its business or comply with regulatory requirements (apart from the reference to the two-year business plan).

There are further requirements for depositories (paragraph 2.3) relating to specialist staff and IT. Registrars have further requirements (paragraph 2.4), relating to employees, organization and IT. Banks which conduct securities business must create a separate structural division (Paragraph 2.5) to carry on that business.

Verification of license applications

The Licensing Instruction describes the procedure for checking license applications. This is a very detailed procedure that includes checking that documents required by the Regulations are supplied in full and are reliable. In some cases, the nature of the documents is such that they can be relied upon (such as official Labor Books on employment). In other cases, separate verification is required and is undertaken. In some cases, the nature of a document is such that some judgment of quality is required. However, the system is designed to reduce areas of discretion to a minimum. Where there is a relevant regulation, the document is judged for consistency with that (for example, the Internal Controls Regulation is the basis for judging the statement of internal controls). For other matters, such as the statement of RM, where there is no regulation, the scope for judgment as to quality is very limited and CBR state that there would be considerable risks of challenge if they were to seek to refuse an application on the basis of a judgment of the quality of the RM controls. Some judgment is applied to the viability of the business plan.

The Licensing Instruction also identifies the grounds for refusing a license. These grounds for refusal appear to be that:

- a) the required documents are not present (including the documents that demonstrate compliance with the integrity, competence, and financial standing tests described above;
- b) the documents do not conform to the legislative requirements (either in respect of securities legislation or otherwise); and
- c) the documents are inaccurate /unreliable.

The nature of these grounds reinforces the observation that the CBR's ability to exercise judgment on the quality or the substance of the documents being submitted is limited.

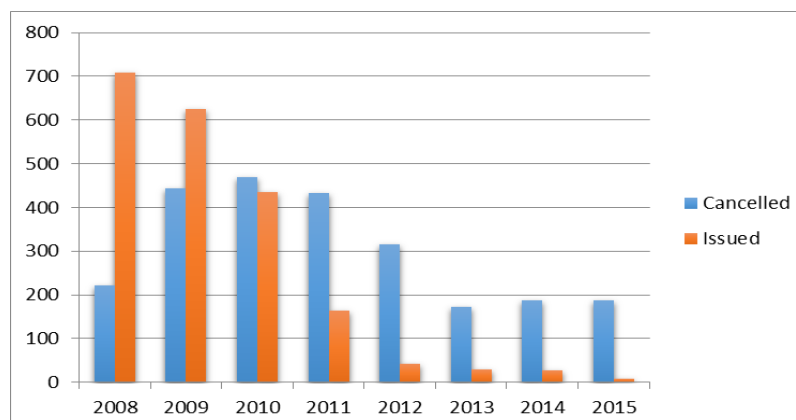
CBR has the power to suspend or cancel a license if there are violations of the law or regulations (Article 44(4) of the Securities Law). The grounds for suspension or cancellation of a license are defined in Article 39.1 of the Securities Law and include violations of specific provisions in the law, multiple violations of any provisions of the law, and bankruptcy. The Licensing Regulation states that the maximum period of suspension is six months (paragraph 3.4).

This detailed licensing procedure and the detailed grounds for cancelling licenses would be expected to lead to a high degree of consistency. The lack of ability to apply discretion reinforces that consistency, although also, as noted above, limits the ability of CBR to examine the quality of the documentation or the substance of the compliance with criteria. The following chart shows the balance of licenses granted and cancelled since 2008. This shows that the number of licenses granted and cancelled has varied very substantially over that period.

The Licensing Instruction has only been in place since July 2015 but an order issued by the FSFR (Order 11–5 of January 25, 2011) followed a similar approach and, legally, is still in force. However, many licenses were issued between 2007 and 2011 according to criteria in a previous Order (07-90/pz-n of August 21, 2007) which CBR state were less stringent and less comprehensive. Licensees came into the market that are now considered unsuitable.

CBR is currently engaged in an exercise designed to remove such unsuitable licensees. In the year from January 2015 to 2016, 18.7 percent of organizations (amounting to over 200) in the securities market have had their licenses revoked without causing any appreciable effect on securities market activity. CBR judge that this fact, together with their other intelligence suggests that the licensees were not required for significant capital markets business but that owners and controllers wanted the licenses for purposes not consistent with the objectives of the regulatory regime. CBR continues to engage in this exercise and still has approximately 70 licensees on a watch list because of concerns that in some (but not all) cases, related to their legitimacy. (This is discussed in the context of Principle 31).

Licenses Issued and Cancelled, 2008–15



Sources: NAUFAR Factbook, 2014 (for 2008–2014), CBR (for 2015).

Maintaining compliance with license conditions

Article 10.1 of the Securities Law obliges a professional securities firm to notify and seek the approval of CBR for the appointment of certain specified officials, including members of the supervisory board and management board. Article 10.2 creates the same obligation for owners of ten percent or more of the shares of a firm. If these owners do not meet the criteria, they are not permitted to exercise voting rights in respect of the shares that exceed 10 percent of total shares issued.

CBR has the power to withdraw a qualification certificate from a senior manager as a sanction for serious or repeated violation (Article 44 (10) of the Securities Law). This would have the effect of removing the person from the securities business for three years, since without such a certificate, a person cannot take up a senior position (FSFR Regulation 10-4 of January 28, 2010).

Reporting requirements are imposed on professional securities firms by Regulation 3353. This instrument obliges a professional securities firm to make reports to CBR on basic information about the firm itself, and its affiliates whenever a change is made. Other information, including details of management and employees and its auditor must be supplied monthly or quarterly. Reporting is also required quarterly in respect of financial information (balance sheet, financial results, etc.) transactions information, information about clients and the work done for them, basic details of the controlling investor, and other matters. However, although there are a large number of specific reporting requirements, there is no general requirement to report any material changes in the circumstances affecting the conditions of a license.

	<p>Disclosures of license status</p> <p>Professional securities firms are required to make available to an investor, on demand, a copy of its license and information about its own capital and own resources (and other matters). CBR state that there is an overall requirement relating to all legal entities to disclose, on request, the identities of all senior officials and those authorized to act in the name of the legal entity. In the future, a new regulation will include provisions to ensure that such information is published in an easily accessible manner.</p> <p>There is no statutory right in the Securities Law to ask for information from applicants. However, CBR can refuse to license if the specified documents are not supplied and the inaccuracy of information is a ground for refusing a license (or cancelling it, once issued).</p>
<p>Assessment</p>	<p>Partly Implemented</p>
<p>Comments</p>	<p>The rating is given because:</p> <ul style="list-style-type: none"> • There is no regulation of investment advisers; • The license criteria do not amount to a fully comprehensive assessment, given the limited tests for integrity, competence and financial standing for senior managers of securities firms and the absence of an overall assessment of capacity and willingness to comply with regulatory obligations; • There is no power for CBR to impose a condition on a license; and • There is no general requirement to report any material change in circumstances that affect the license. <p>CBR have suggested that the power in the Investor Protection Law to impose restrictions on a licensee in the event of a violation amounts to a power to impose a license condition. This is not so. The point of a license condition is to circumscribe the operation of the license and this may be for any reason, not just arising from a violation of regulations. Frequently such conditions are imposed on new licensees who may not have conducted any business and therefore could not have violated any regulation.</p> <p>Strictly speaking, such findings would result in an assessment of Not Implemented. However, although the relevant Key Questions cannot be answered fully in the affirmative, the law and practices go a considerable way towards meeting the criteria. The rating has thus been adjusted to "Broadly Implemented."</p> <p>The very detailed list of required documents and verification procedure should result in a high degree of consistency. The chart above shows that license granting and cancellation has shown very considerable volatility</p> <p>Nevertheless, the assessors have not concluded from this that the rating should be affected by any apparent inconsistency. CBR is to be commended for the action it has taken on new</p>

applications and existing licensees and should not be criticized for the fact that this very proper approach is inconsistent with previous practice.

The integrity tests do not include such matters as the personal bankruptcy of individuals, or adverse findings by a professional organization or SRO. Administrative disqualifications are disregarded after they have been completed, regardless of the seriousness of the incident that led to the disqualification. There is no reference in the statutory tests to the implications of employment termination by a previous employer. The test as regards the criminal convictions applies only to unexpunged economic crimes (however serious) and not to other crimes (again, however serious). There is no requirement as to the relevance of work experience, beyond the requirement that it be in a financial organization.

CBR have explained that there is a strong tradition in the Russian Federation of opposing the granting of discretion to state agencies, in case it is subject to abuse. However, the consequence, in the case of the criteria for licensing is that there are a small number of very specific tests on competence, integrity that cannot be regarded as comprehensive. There is no test regarding financial standing of an individual. CBR state that there is a new draft law to amend the Securities Law to strengthen the criteria for owners, managers, and other officials of professional securities firms. The assessors have not seen a draft of this new law.

It is important that CBR should be able to insist on disclosure of a wider range of matters affecting competence, integrity, and financial standing and should then be able to consider the relevance of such matters in the context of the position to be held. The wider disclosure should include findings by any professional association or SRO, any employment dismissal (or resignation, where failure to resign would result in dismissal). Personal bankruptcy or agreement with creditors (where bankruptcy would otherwise result) should be disclosed. Work experience outside the financial sector should be capable of being accepted, if relevant to certain positions but not all work experience in the financial sector need necessarily be regarded as relevant.

Ideally, there should be a more general disclosure obligation to report any matter that might reasonably affect the judgment of CBR as to the suitability of a person to hold the relevant position in the professional securities firm.

The difficulties faced by CBR in moving in this direction are understood. However, CBR have indicated that they wish to publish a new regulation that would enable them to consider a broader range of matters, including business reputation and this is to be encouraged.

Moreover, the industry perception is that, for businesses that have been licensed and are operating in the market, CBR is now making informed judgments about the quality of RM for a business rather than compliance with a set of specific rules and this approach is also to be commended.

It is important also that CBR should be able to impose, change, and withdraw license conditions. License conditions are useful to enable CBR to limit the activities of a professional securities market firm, where it considers that it has, temporarily, insufficient capacity to carry out its business, or if it is needed to allow time for the firm to re-organize itself or for many other reasons.

The IOSCO Principles and methodology state that, where an investment adviser does not deal on behalf of customers and does not hold client assets, it may not, strictly speaking be necessary to regulate such activity, provided that it provides advice through licensed intermediaries. The difficulty is that, there is no requirement to act through licensed intermediaries and without some level of regulation, it is not possible for CBR to judge whether or not advisers are, in fact, holding assets or dealing. Moreover, the provisions in the law that are discussed in the context of Principle 31, with respect to establishing the investment objectives of a client and providing information sufficient to ensure a full understanding of risks would be equally relevant to the work of an adviser, even if such an adviser did not deal or hold assets. There is a strong case, therefore, for bringing investment advice within the scope of regulation. It is understood that CBR intends to do this, and this is to be commended.

Recommendations

CBR should seek changes to the law, or make changes to regulations as appropriate so that:

- The integrity criteria (and the matters to be disclosed by the license applicant) should be broader than those in Article 10 of the Securities Law, as described above;
- There should be a more general disclosure obligation to report any matter that might reasonably affect the judgment of CBR as to the suitability of that person to hold the relevant position in the professional securities firm;
- CBR should have discretion to consider the seriousness and relevance of any matter to the integrity, competence, and financial standing of the person involved when determining whether or not they can be permitted to be a manager or owner of a professional securities firm;
- CBR should have broader discretion to judge the adequacy of the organization and governance of an applicant and the adequacy of its RM (including internal controls and conflicts of interest policy);
- CBR should be able to grant a license with conditions and should be able to vary, or remove such conditions;
- A professional securities firm should be under a general obligation to report any material change in circumstances or any other matter that may reasonably be expected to affect the CBR's view on whether it should be able to continue to hold its present license;

	<ul style="list-style-type: none"> • CBR should develop the criteria to be used to judge the adequacy of the organizational structure, the RM process, the internal controls, and the management information system; and • CBR should seek an amendment to the Securities Law so as to bring investment advice into regulation.
Principle 30	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	<p>Regulation 8-41 of October 23, 2008 (the Capital Calculation Regulation) specifies how the level of “own funds” (hereafter called capital) is calculated. This lists the assets that may be included in the calculation and the liabilities that must be excluded. It amounts to a net asset calculation.</p> <p>Direction 3329 of July 21, 2014 (the Capital Direction) specifies the capital requirements for intermediaries, including brokers, dealers, investment managers, custodians, and registrars. The capital requirement for each kind of activity is a flat rate. The requirement is lowest for dealers and highest for custodians. The requirements for brokers vary according to the business they undertake and whether or not they are members of an SRO that meets certain criteria.</p> <p>The capital requirements of the Capital Calculation Regulation do not apply to banks that also undertake securities activity.</p> <p>There is no liquidity requirement. The Capital Calculation Regulation allows the professional securities firms to include fixed assets like property in the net asset calculation (Paragraph 3.1). The calculation of assets includes intangible assets, although this is subject to a 40 percent reduction (paragraph 4). There is no requirement that the securities firm must have any minimum level of liquid assets.</p> <p>There is no requirement that the capital should be such as to enable the professional securities firm to absorb some losses and wind down in an orderly manner. Since the calculation of capital in the Capital Calculation Direction includes fixed assets and intangible assets, it cannot be regarded as addressing the risk of insolvency, since in practice, in the event of a deterioration in the business of a securities firm, the value of realizable assets may well be lower than liabilities, even if the calculation of capital resulted in a number that met the requirements of the Capital Direction.</p> <p>The differences between the requirements for professional securities firms undertaking different activities are clearly intended to match risk in a general way. However, dealer capital requirements are lowest of all at RUB 3 million, or US\$40,000 (paragraph 4(d) of the Capital Direction). Since dealers take market risk positions, this figure looks very low. The requirement for brokers that can use client funds in their own interest (discussed further in the context of Principle 30) is RUB 35 million (US\$500,000), unless they are a member of a qualifying Self-Regulatory Organization, in which case, the requirement is RUB 15 million (US\$200,000) (paragraphs 4(a) ad (b)).</p>

	<p>The capital amount does not vary with the size of the firm or the volume of business and therefore cannot be said to address the full range of risks. The calculation of the flat rate does not explicitly address market, credit or liquidity risk. The framework does not address risks from outside the regulated entity.</p> <p>The capital calculation regulation imposes a requirement to maintain the prescribed level of capital at all times (paragraph 2.5 of the accompanying order) but there is no specific regulatory requirement that directly obliges professional securities firms to maintain records that would enable them to determine their capital levels at any time. The Capital Reporting Direction 3533 of January 15, 2015 obliges firms to make monthly and quarterly reports of financial information. The calculation of own funds must be made monthly on the last day of each calendar month.</p> <p>Monthly and quarterly reports must be drawn up in a form that is prescribed in a CBR Direction (for example Direction 3533-U of January 15, 2015 (the Capital Reporting Direction) for brokers. The forms must be submitted within one month of the calculation. The forms would enable CBR to detect a deterioration of capital (as shown in the annexes to the Capital Reporting Direction) at the time of the report. However, there is no general obligation to report a deterioration of capital at any time.</p> <p>Each professional securities firm must have its annual financial statements audited (Article 5(3) of the Auditing Law). However, there is no provision that requires the auditor to check that the financial position reflects the full range of risk and there is no such requirement in the legislation on auditors. There is no deadline for the submission of the audited report in the Auditing Law. CBR have stated that the deadline of 120 days that is in Law 208 on consolidated financial statements, also applies to professional securities firms, even though the law itself does not include professional securities firms in the list of organizations covered by the law (Article 2(1)), unless they are listed on an exchange.</p> <p>The monthly and quarterly reports required by the Capital Reporting Direction enable CBR to review the capital levels of professional securities firms. CBR state that they send instructions to raise capital levels but they have also made clear that they cannot do this unless the firm is below the minimum and if that were the case, CBR would be considering cancelling the license.</p> <p>There is power to appoint an administrator to take over the control of a professional securities firm in Law 127 of October 26, 2002 on Insolvency (Article 180 et seq). However, CBR can only do this if the firm meets certain conditions, which are listed in Article 183.2 of Law 127 of October 26, 2002 (the Insolvency Law). These conditions include a repeated refusal for a month to meet obligations to creditors and other conditions that would amount in effect to a default. Failure to meet minimum capital levels is not, itself, a criterion for using the CBR powers. These powers are not available to enable CBR to take action in advance so as to avoid a default.</p>
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	<p>The powers exist in the Insolvency Law to take control, restrict activities, sell assets, transfer client accounts. However, as noted above, these powers cannot be used in advance of a default.</p> <p>CBR have stated that they have used the general powers in Article 11 of the Investor Protection Law to restrict the activities of professional securities firms with limited capital. They do not regard the broader powers in that article as being available to transfer client assets of a broker with limited capital to another broker—unless the conditions for appointing an administrator under the Insolvency Law are met.</p>
Assessment	Not Implemented
Comments	<p>This rating is given because:</p> <ul style="list-style-type: none"> • The capital requirements have no element for liquidity and do not address solvency—indeed, by including such items as intangible assets and reserved tax assets in the calculation as well as fixed assets, the provisions give no guarantee that there will be sufficient assets to meet obligations in the event of a business failure; • The capital requirements do not address the full range of risks to which professional securities firms are subject as they are flat rate, taking little account of the detailed nature of business; • The flat rate capital requirements do not fully reflect the different risks of different categories of licensed activity; • The capital requirements are not sensitive to the quantum of risks; • The capital requirements are not calculated on the basis that they should be sufficient to allow the intermediary to absorb some losses and wind down in an orderly manner; • There is no specific requirement to maintain records that allow capital levels to be determined at any time; • There is no requirement that auditors should check that the capital is sufficient to match the full range of risks to which a firm is subject; • There is no requirement to report deterioration immediately to CBR; • The CBR's powers to intervene in the Insolvency Act cannot be used in advance of conditions being met—which amount, in effect, to a default and so they do not have powers to transfer assets of clients to another firm, prior to a default; and • The capital requirements do not address risks from outside the regulated entity. <p>CBR states that it is contemplating a new regulation (or regulations) that would:</p> <ul style="list-style-type: none"> • Be risk based, drawing on the methods of assessing capital for banks under the Basel capital accords;

- Include a requirement on professional securities firms to report a deterioration of capital of 50 percent from the last monthly report;
- Include a further requirement that a securities firm should ask its auditor to report on the adequacy of the level of capital to address the full range of risks.

CBR also note that professional securities firms will be subject to IFRS as from 2017.

CBR has defended the flat rate capital levels on the basis that the own funds capital calculation is simple and cheap and that it provides for an excess of liquid assets over liabilities. Whether the capital calculation could be described as simple is debatable. The Capital calculation regulation allows a securities firm to include assets that are certainly not liquid such as immoveable property and intangible assets, which may not have any value in the event of failure. It is thus not certain that the capital would be sufficient to meet liabilities if an intermediary failed.

CBR has defended the low level of capital for dealers on the basis that, although they are regulated, they do not have any more significant effect on a market than any ordinary non-regulated person who trades on exchanges. The assessors would respectfully disagree. The definition of a dealer in the Securities Law (Article 4) shows that they perform a role, typically described as "market making" in other countries (although that term is used with a different meaning in the Securities Law). They must make public prices and volumes at which they are committed to deal. The failure of such a firm could have a disruptive effect on market stability and liquidity (if they were one of a small number of dealers making prices in a specific security). Moreover, in practice, most dealers are also brokers and, in their case, the fact that they are taking on positions in their own name may also pose a risk to their clients. It is recognized that brokers that use their clients' funds in their own interests are given much higher capital requirements than those who do not. Moreover, the trading activities of dealers is restricted by the clearing system by reference to their capital. Nevertheless, the assessors consider that the current capital requirement for dealers does not reflect the considerable market position risk that a dealer is likely to take.

CBR have also noted that it would be difficult for a professional securities firm to calculate their own funds requirement on a daily basis because some assets (such as property and equipment) can take some time to value. However, the assessors would note that there is little point in imposing a requirement to report a 50 percent deterioration of capital since the last report (which is the CBR's intention) if securities firms cannot know their capital on a daily basis. In fact, there is a simple solution to this problem. The securities firms should be given instructions on how to calculate capital on a daily basis by making assumptions about the change in the value of non-quoted assets between the end of one reporting period and the next. Since non-quoted assets may be difficult to realize in an insolvency, it would be preferable to remove them altogether.

The reforms that CBR are intending to make are definitely an improvement on the current position. However, the proposal to require a report of a decline of 50 percent since the last

	<p>report of own funds is inadequate on its own, since it implies a substantial capital reduction that would indicate imminent default. The requirement should be to report a deterioration of 50 percent of the excess capital over the minimum. Moreover, there should be a requirement to report immediately if capital levels fall to within 20 percent of the minimum. This needs to be accompanied by a requirement to calculate capital levels daily.</p> <p>Recommendations</p> <p>CBR is commended for embarking on a reform to its regulations for the capital of professional securities firms. It should ensure that the new regulation, or regulations:</p> <ul style="list-style-type: none"> • sets capital requirements that are based on the full range of risks to which a professional securities market firm is subject, taking account of the nature, scope and scale of its activities; • require the capital to be maintained at all times; • imposes a liquidity requirement that would ensure that a professional securities firm could absorb some losses and wind down the business in an orderly manner; • creates an obligation on a professional securities firm to report a deterioration in the excess capital (i.e., the capital held in addition to the minimum requirement) of 50 percent since the last report; • sets a further obligation to report to CBR if their capital falls below 120 percent of the minimum; • requires securities firms to make a daily calculation of capital and place this on the file so that CBR and auditors can select days at random to check that such calculations are being undertaken properly; • sets a deadline for the submission of annual audited reports; and • sets a requirement on securities firms that they should get an annual opinion from their auditors on whether their capital is sufficient for the full range of risks. <p>CBR should seek an amendment to the law so that their intervention powers would allow them to take action to restrict the activities of a securities firm, to transfer client assets to another firm and take other action when, in the opinion of CBR, it is necessary in order to avoid an imminent risk of default which would endanger the market or the interests of investors.</p> <p>The recommendations made above in Principle 29 regarding the power to place a condition on a license is also relevant here.</p>
Principle 31	Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct with the aim of protecting the interests of clients and their assets and ensuring proper

	management of risk, through which management of the intermediary accepts primary responsibility for these matters.
Description	<p>Internal controls</p> <p>Regulation 481 of July 27, 2015 on licensing (the Licensing Regulation) makes specific provisions for the management of a professional securities firm. It states that a condition of receiving a license is that a professional securities firm should have a supervisory board (paragraph 2.4.5). The firm must also appoint a CEO, compliance officer (paragraph 2.1.2 and 2.1.3), and finance director (2.2.1). There are further requirements for certain specialists in the activities conducted by the licensee (paragraph 2.3 and 2.4).</p> <p>Article 10.1.1 of the Securities Law obliges a professional securities firm to organize and exercise internal controls and to document such controls. The firm must also establish a RM department and a risk monitoring system. The Licensing Instruction requires an applicant to provide a statement of internal controls. There is no general obligation placed on the securities firms as to the adequacy or coverage of such internal controls.</p> <p>The Internal Controls Regulation is almost exclusively about the appointment, qualifications, duties, and functions of a compliance officer, although there are some other provisions, such as requirements relating to complaints, discussed below. It creates an obligation for a professional securities firm to appoint a compliance officer who is also the deputy CEO. It also places responsibility for compliance with regulatory obligations and the implementation of internal controls on the compliance officer. CBR state that this obligation placed on the compliance officer is overridden by the corporate law requirement that responsibility for such matters lie with the CEO.</p> <p>The Internal Controls Regulation creates an obligation on the compliance officer to report regulatory breaches to the CEO (paragraph 4.5) and make a quarterly report to the supervisory board (paragraph 4.7). This report is primarily about the breaches of regulations, the measures taken to rectify those breaches, and the results of investigations into complaints (paragraph 6.2). There may also be reports on conflicts of interest and recommendations for training.</p> <p>There is no general obligation to implement a management information system that provides the management of a professional securities firm with sufficient information to enable it assess the effectiveness of its internal controls in meeting the regulatory obligations.</p> <p>There is no general obligation to have a regular review of internal controls and RM processes, except insofar as these may be reviewed by an external auditor. Part V A of the Corporate Governance Code states general principles for internal controls and RM. However, compliance with the code is voluntary. Moreover, the introduction to the Code notes that it is primarily intended for listed companies.</p>

CBR state that, during onsite inspections, they check the effectiveness of the compliance function and in particular the reports made by the compliance officer.

Conflicts of interest

Article 3 of the Securities Law states that a broker (but not other securities firms) must compensate a client if a conflict of interest was not disclosed to the client in advance of an order and the client suffered loss. Article 5 includes a similar provision for investment managers. The Securities Law also includes some conflict of interest disclosure provisions in respect of bond holders (Article 29.1 et seq). Article 44(3) empowers CBR to make regulations on conflicts of interest.

Regulation 44 of 1998 defines a conflict of interest as being between a professional securities firm and its employees on the one hand and a client on the other. It places a general obligation to put the client's interests before those of the securities firm. It also requires SROs to develop standards designed to avert the occurrence of conflicts of interest. However, this Regulation does not provide any guidance on what actions should be taken to address conflicts of interest (for example by creating information barriers, by disclosure or by declining to act).

Regulation 482 of August 3, 2015 (the Investment Management Regulation) contains two short references to conflicts of interest with respect to investment managers. Paragraphs 6.1. and 6.2 require an investment manager to identify, monitor, and manage conflicts of interest (6.1). If the risk mitigation measures are not sufficient to prevent the risk of damage to the client, the manager must notify the client (6.2). However, this does not apply to other securities activities, it does not require the investment manager to decline to act if the measures are insufficient and it does not give any indication of the measures that might be taken. CBR have also observed that there is a more general definition of fiduciary responsibilities in the Civil Code, which include the obligation to act in the best interests of the client.

Licensing Instruction 168 (paragraph 2.1.29) states that an applicant must supply a document listing measures that have been put in place to address conflicts of interest. This requirement in the licensing instruction does not apply to firms that only conduct one form of activity (implying that the only conflicts are between different kinds of activity). In practice, the vast majority of brokers are also dealers and many of them are investment managers as well. So most licensees will be caught by these provisions. Licensing Regulation 481 also obliges an applicant that is engaging in certain specified combinations of activities (such as broking and dealing, or broking and investment management) to create exclusive structural sub-divisions for each area of activity. For example, there should be a separate sub-division for depository activity, a separate sub division for broking, for dealing and for investment management. However, there are no requirements for ensuring that there are information barriers or other practical safeguards designed to manage conflicts of interest.

There are otherwise no general provisions requiring a securities firm to address conflicts of interest arising with a client or those between clients, or to have mechanisms for managing

	<p>conflicts of interest, which should include disclosure, internal organizational barriers or a decision to decline to act.</p> <p>Segregation of duties</p> <p>The Licensing Regulation 481 states that certain specified combinations of securities market activities must be accompanied by measures designed to mitigate the risk of conflict of interest (paragraphs 2.2.1, 2.3.1 et seq). The Internal Controls Regulation specifies the functions that a compliance officer may not perform, in combination with the compliance officer role (paragraph 3.2).</p> <p>However, there is no general requirement for the segregation of duties where the performance of such a combination would create unmanageable risks of conflicts of interest, undetected errors, potential breaches of internal controls or abuse more generally.</p> <p>Client protection and risk management</p> <p>There are no general requirements that oblige the professional securities firm to have in place appropriate systems of client protection and RM.</p> <p>There are detailed record keeping provisions regarding the taking of client orders in the Record Keeping Regulation but there are no general provisions requiring a firm to have systems in place to ensure the integrity of its dealing practices and the fair, honest, and professional treatment of clients.</p> <p>There are no provisions relating to the controls necessary to prevent a client that has direct access to an exchange from placing an order that exceeds specified limits. In practice, those professional securities firms that allow their customers direct access to the market do impose controls of a greater or lesser degree of sophistication. These controls, as explained to the assessors, place limits on the trading activity of the client, depending on the cash and collateral provided to the broker by the client. A broker is thus able to take steps to control risks. The risks taken by any market participant are also controlled to some extent by the arrangements for posting margin and collateral (discussed in Principle 37). There do not appear to be any specific requirements on brokers to control the risks inherent in direct client access to the exchange, beyond the general requirement to have an adequate RM system. (Article 10.1.1).</p> <p>There are no requirements on professional securities firms to act with due care and diligence in the interests of the client or in a way that protects the integrity of the market.</p> <p>Segregation of client funds</p> <p>Article 3 of the Securities Law states that, where a broker holds client money, it should be held in a special broker's account that is clearly designated as being for clients and the bank cannot</p>
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use the money in that account to satisfy the liabilities of the broker. Article 3 also provides that the broker should keep accounting records that identify the client money held.

Article 7 of the Securities Law states that it is not possible to use client securities held by a custodian to meet the liabilities of the custodian. Article 7 contains similar provisions with respect to client money as those in Article 3 with respect to brokers.

There are no comparable provisions for other intermediaries such as investment managers, who may also hold client money. However, CBR state that clients are protected in that case by the provisions of the Civil Code (Chapter 53).

Article 3 of the Securities Law states that, for some brokers, it is acceptable for the broker to use client money in its own interests, provided that this is allowed for in the client agreement. The capital requirements are considerably higher for such brokers (Regulation 3329). Article 3 obliges the broker to keep funds in this category separate from those of client funds where there is no agreement to use them in the broker's interests. The broker must undertake to follow client's instructions for such funds and return them when requested to do so. CBR state that this arrangement could enable the broker to use the funds and speculate in the market to its own profit. Any loss would have to be made good, unless the broker were no longer in a position to meet such liabilities. In practice, however, this arrangement is normally used to enable the broker to lend to other clients and to manage minor and temporary shortfalls in the funds available to meet commitments where the scale of the shortfall would not justify cancelling a securities purchase, closing out a derivatives position or taking other action to recover funds beyond simply calling on the client to make up the difference in due course.

Apart from the enhanced capital requirements and the reference in the client agreement, there are otherwise no safeguards to protect the client money in the event of a default by the broker.

There are no obligations to ensure that this element in a client agreement is given prominence, nor is a broker required to explain the increased risks associated with this practice.

If a broker were to fail, and there was a shortfall in the client account, the Insolvency Law states that the clients would be paid pro rata to the amount in the client account and would be unsecured creditors for the remainder.

Paragraph 57 of the record keeping regulation obliges professional securities markets firms to reconcile their records of client money every month and client assets every three months.

There are no other safeguards to protect client assets. There is no obligation to entrust securities held on behalf of an individual investment portfolio client to a custodian.

Complaints

Chapter VII of the internal control regulation sets procedures for the handling of complaints. These gives details of the steps that should be taken and include strict timetables. There is no direct obligation that complaints should be handled fairly. The reply must be signed by the chief executive of the securities firm, or by the compliance officer. There is no obligation to ensure that a complaint against the actions of a specific person should be investigated by a different person, although the requirement that the response is signed off by the CEO or compliance officer goes some way to achieving the same effect.

Client identity and investment profile

There are no provisions in the Securities Law that oblige professional securities market firms to identify and verify the client's identity using reliable, independent data, including the persons who beneficially own and control such securities.

Article 7 of the AML Law imposes a requirement to obtain and keep records of client identity. There are certain exceptions to this rule—namely where transactions involve less than RUB 15,000 (US\$200) (Article 7(1.1, 1,2, 1,3)). Such an exception is not permitted under the IOSCO Principles. The AML Law includes a general requirement to identify the beneficial owner (Article 7) and this is defined in Article 3 to include any person with a direct or indirect control of 25 percent of the shares of a legal entity.

However, for a natural person, the law permits the institution to assume that a natural person is the beneficial owner unless there are reasons for supposing otherwise. Moreover, Article 7 also says that if “affordable” measures are taken and still do not identify the beneficial owner of a legal entity, the executive body of the legal entity can be assumed to be the beneficial owner. Such provisions are likely to result in cases where the beneficial owner is not identified—especially if shareholder of the Russian legal entity is owned by a foreign legal entity.

The Investment Management Regulation 482 (paragraphs 1.2 and 1,3) obliges an investment manager to create an investment profile for a client that consists of:

- statement of the loss the client can bear;
- he desired return on assets; and
- the investment horizon (which must not be longer than the client contract).

Information is also to be collected on the age, income, and expenditure over 12 months and savings (1.4). There is a general obligation to seek to achieve the investment objectives of the client (1.1), although there is no corresponding objective to establish fully what that objective might be.

However, this regulation only applies to investment managers and not to other professional securities firms. The description of the elements of the investment profile is limited and there is

no overriding obligation to gather sufficient information to ensure that services provided are relevant and appropriate.

Any accounting records that are kept by the professional securities firms must be kept for five years by virtue of Article 29 of the accounting Law and in the Record Keeping Regulation (12–32).

Client disclosures

There is no general requirement in the Securities Law that a client should be given a written client agreement, although Article 7 of the Securities Law mandates a written agreement between a depository and the client. CBR have stated that a requirement for a written agreement can be found in Articles 159 and 161 of the Civil Code. However, there are no specific provisions as to the nature of a client agreement that are relevant to a securities firm and its client.

There is no provision that requires a professional securities firm to disclose sufficient information on a proposed investment to enable a client to make an informed decision. Article 6 of the Investor Protection Law specifies certain information that must be disclosed—but only at the request of the investor. There is no obligation on the securities firm to provide this information spontaneously and certainly no requirement that the disclosure should be timely and comprehensible.

Paragraphs 64 to 72 of the Record Keeping Regulation require a professional securities firm to submit reports to a client at various intervals, depending on the nature of the activity but no less than once a quarter.

There are no general requirements to disclose fees and charges to a client, although CBR state that there are some requirements placed on depositories and registrars in regulations that have not been made available.

Supervision

Responsibility for the supervision of professional securities firms is split between the CBR's headquarters and territorial units. The general policy on supervision and the development of supervision methodology is the responsibility of the headquarters unit, as is the practical supervision of the 30 largest firms, which account for 75 percent of the business. Responsibility for supervision of other firms is given to territorial units. The headquarters policy unit is responsible for developing a consistent methodology to be used by headquarters and territorial staff.

From 2015 onwards, CBR has started to move towards a risk-based supervision system. Although not mandated by instruction, headquarters units have developed a risk scoring system that divides the securities firms into five groups. CBR use a range of information to

allocate firms to these risk groups, including information about the firm's physical location and behavior. As well as information on financial flows, transactions data, the monthly and quarterly reports submitted by the firms, the extent of borrowing by the firms, news reports, and the judgments of supervisory officials. Information from elsewhere in CBR about payments and insurance are also used.

CBR has focused on brokers, dealers, investment management and depositories. Not all securities firms have been subjected to risk scoring by the time of the assessment but 430 had been categorized to one of the five risk groups, as follows:

Green		Yellow	Red		Total
I	II	III	IV	V	
46	166	38	121	59	430

The most risky firms are described as the red zone. For these firms, all of which are smaller firms and hence within the supervisory responsibility of the territorial units, there is a system of intensive supervision. This includes inspections, requests for more detailed information and weekly reports on activity by the territorial units. These are the firms that headquarters suspect may need to be considered for license cancellation on the grounds that the business they are doing, or the financial and corporate structure of the firm is of an unusual character, justifying a suspicion that they may not be engaged in legitimate securities activity.

The result of this intensive supervision regime is that 250 firms have left the market:

- 91 firms had their licenses revoked (59 did no activity, 28 were found to be in serious breach of the regulations);
- 38 firms left because they were part of a bank whose license had been cancelled;
- 115 gave up their license voluntarily; and
- 6 left the market for other reasons.

In addition, CBR cancelled the qualification certificates of 64 persons and issued orders for 228 administrative penalties. There were 1,163 separate orders to prevent violations.

The offenses that have been detected include:

- The inclusion of ineligible assets in the calculation of the capital of professional securities firms;
- Improper categorization of investors as qualified;
- The use of securities firms to conduct illegal gambling; and
- Inaccurate records of client information by depositories.

For firms that are not subject to the intensive supervision regime, CBR analyzes the monthly and quarterly reports according to a methodology developed by headquarters units. CBR, meets management from time to time to discuss stress testing, market developments, new products and services, and other matters. CBR also conducts inspections—both full scope and thematic.

CBR is not yet in a position to impose RM and good governance practices on professional securities firms, although some have voluntarily conducted risk assessments.

In addition to this specific focus on removing brokers with little or no activity, CBR engages in a supervisory program that involves analysis of periodic reports and onsite inspections. These are conducted by separate teams—an offsite team and an Inspections Department. The Inspections Department conducts inspections for all banks and nonbank financial institutions and do not have specialist teams for securities firms. See the detailed discussion of this in Principle 12.

Periodic reports consist primarily of financial information and include changes in the basic information about the business of the licensee and its affiliates (if any).

Inspections are both scheduled and unscheduled. Unscheduled inspections are, essentially, investigations into complaints or other suspicions of breaches. What are normally called routine onsite inspections are known in CBR as scheduled inspections. These are based on CBR's knowledge of the number of complaints and breaches. There is no attempt to maintain a risk scoring system that identifies the risks associated with each licensee, based on the nature of its business and customers, its transactions or the quality of its RM.

Inspectors are given specific targets and objectives by the offsite team, based on the knowledge of the licensee arising from periodic reports and other intelligence.

Inspectors review internal documents and client files to examine compliance with the applicable laws and regulations. Where they come across more egregious compliance failures, they will alert the offsite team so that immediate action can be taken. Where client files are examined, the intention is primarily to detect any suspicious activity by the client. There is no focus on the extent to which the client files demonstrate the application of the professional securities firm's responsibilities to the client, for example, to collect appropriate information on financial objectives and circumstances.

The inspection team maintains contact with the offsite team during the inspection and discusses findings with them, so that the findings can be agreed before the conclusion of the inspection. The final report is given to the licensee at the conclusion of the inspection.

The description of the inspection process given by the inspection team focuses on compliance with the detailed rules. In discussion of the merits of a broader set of requirements for the key obligations concerned with good RM, adequate internal controls, conflicts of interest, the

	<p>inspection team considered that it would be difficult in practice to impose sanctions on such matters, short of a breach of a detailed specified rule.</p> <p>However, discussion with the private sector showed that, in practice, the CBR inspectors do discuss compliance with general obligations, such as the obligation to impose good RM and that the discussion is helpful in that it results in specific suggestions for improvement.</p> <p>CBR were unable to provide data on the number of inspections of professional securities firms but data from the Annual Report in 2014, there were 97 scheduled inspections and 499 unscheduled inspections for the 19,000 entities for whose regulation CBR is responsible.</p>
Assessment	Not Implemented
Comments	<p>The rating is given because of the following departures from IOSCO requirements:</p> <ul style="list-style-type: none"> • There is no overriding obligation placed on a professional securities firm to act with due care and diligence in the interests of a client, to place the interests of the client above its own, and to have systems and controls that ensure the integrity of its dealing practices, the integrity of the market and the fair, honest, and professional treatment of clients; • There are no overriding obligations to have adequate internal controls, which should include requirements placed on the management of a professional securities firms to undertake a risk assessment of its business, to devise policies and procedures that address those risks, to train staff in those procedures, to have an information system for assessing effectiveness of those policies and procedures, to review the effectiveness at least once a year, and to reassess the risks at least once a year; • There are no effective overall provisions that oblige any professional securities firm to identify and prevent, or manage conflicts of interest—by disclosure, internal organizational barriers or by declining to act; • There is no provision that obliges a professional securities firm to ensure that there is appropriate segregation of duties where necessary to prevent unmanageable risks of conflicts of interest, undetected errors, or abuse more generally; • There is no general obligation to provide a written client agreement (except for depositories) in a form that ensures that the matters CBR consider relevant are included; • There is no overall obligation on a professional securities firm to obtain sufficient information about the client’s circumstances and objectives to enable them to provide appropriate services and advice; • There is no obligation on an investment manager to hold client funds in a segregated account (apart from the general obligations in the Civil Code); • There is no obligation to identify all clients and the beneficial owners;

- There is no general requirement to give a client enough information to make an informed investment decision; and
- There is no obligation to disclose fees and charges.

Further, some of the arrangements within the regulatory regime are not appropriate:

- It is not appropriate to allow a broker to use client funds, without limit, in its own interests, even if permitted in the client agreement. There is clear scope for abuse in such an arrangement, especially as there is no requirement that the matter should be disclosed prominently in the agreement nor are there any specific safeguards for this use, beyond those described above. There is a major risk of such arrangements being abused and resulting in losses to the client. The risk arises, particularly if the broker's use of the funds leads to a loss that is too large for the broker to absorb. There are no provisions designed to mitigate this risk or other mechanisms in place, such as an investor protection fund to compensate clients who suffer losses of this type.
- It is not appropriate to place responsibility for complying with laws and regulations on the compliance officer. The responsibility should be placed on the executive management of the securities firm. Although the specific provision in the Internal Control Regulation should be read in conjunction with the normal requirements of corporate law, there is a clear danger that, without a specific provision in the securities regulatory regime, the executive management of a securities firm may seek to evade responsibility by pointing to the Internal Control Regulation's provisions regarding the compliance officer.
- It is not appropriate to permit a securities firm to accept a client where the beneficial owner of the account is not known. If reasonable and affordable measures to not result in the identification of the beneficial owner, the firm should refuse to act. There is otherwise too great a risk of market abuse by people who hide behind the anonymity of corporate structures and other organizational forms.
- It is not sufficient for a professional securities firm to reconcile their client money accounts every month and the client assets every quarter. Client money reconciliation should be undertaken daily. Client asset reconciliation should be undertaken weekly for intensive trading clients and monthly for others, unless there has been no trading for three months, in which case, the reconciliation could be quarterly.

There are some provisions that partly address some of these issues but they are not sufficient.

For example, Article 10.1.1 of the Securities Law, introduced in July 2015) now requires a professional securities firm to have an adequate system of internal controls and RM and Licensing Instruction 168 requires an applicant to give a description of internal controls. Licensing instruction 168 also requires a description of the RM system. However, there are no adequate supporting provisions to give substance to these provisions.

In addition, the Investment Management Regulation includes some provisions that specify the information that an investment manager should obtain from a client (as described above). The specified information will usually be relevant and sometimes sufficient. But circumstances vary and there will be many cases when the information listed in the regulation is not sufficient to give a true picture of the risk appetite and financial circumstances of the client. The applicable legal regime should impose a general obligation to require the collection of all information necessary to enable all professional securities firms (investment managers, brokers, and dealers) to understand the financial objectives and circumstances of their clients such that the firms can provide appropriate services.

There are a number of provisions that refer to the management of conflicts of interest and these are described above. Some are of general application (such as Regulation 44 of 1998) and some are partial, such as the obligation on brokers, but not others, to compensate clients for losses arising from undisclosed conflicts of interest (Article 3 of the Securities Law).

The assessors noted that CBR, in their comments on the report of this principle referred to two other instruments (Regulation 3797 U of September 13, 2015, Order 3234-U of April 18, 2014). In fact, Regulation 3797 is about forex dealers' SROs and hence is not relevant to this assessment. Regulation 3234 contains detailed provisions about the value of client portfolios and margin payments and while these may have some relevance to conflicts of interest, there are no general provisions about conflicts of interest in this Regulation.

The assessors also noted that CBR made no reference to these two regulations (3797 and 3234) at any stage in their self-assessment, nor in discussions, prior to the reference in the comments made on the draft report. There is also no reference in the self-assessment to Regulation 44 of 1998 (which is, in fact, a general requirement relating to conflicts of interest and highly relevant to the assessment). Nor was any reference made to this regulation in any discussions on conflicts of interest prior to their final meeting with the mission. The assessors are bound to conclude that:

- provisions on conflicts of interest are included in a piecemeal and inconsistent manner in different legislative instruments;
- CBR does not itself appear to have a consistent and comprehensive view of the nature, extent and application of these provisions and that; and
- the conflicts of interest provisions are not sufficiently comprehensive for the purpose of the principle and are not adequately enforced.

The assessors would also suggest that reliance on other provisions in the Civil Code may not be sufficient:

- The fact that a written agreement is mandated explicitly in Article 7 of the Securities Law for depositories undermines the argument that the provisions of the Civil Code render an explicit provision in the Securities Law unnecessary.

- A provision in the Securities Law or appropriate regulation would give CBR scope to specify some of the matters that should be included in that agreement and the way they should be displayed. For example, it may be appropriate to give prominence to the broker's use of client money (so long as CBR permits this practice) and the risks of so doing. It would be possible to mandate the disclosure of fees and charges and to specify the kinds of rights and obligations of both parties to the agreement.
- It may not be appropriate to rely on the Civil Code to impose a requirement for the segregation of client funds by an investment manager. It may well be that the Civil Code has relevant provisions but the absence of a specific provision in the Securities Law, despite their being prominent provisions with respect to brokers and custodians gives the Securities Law an unbalanced appearance and it may be that some firms assume that there is no such segregation requirement in that case.

The assessors also noted that the inspection team, in its description of its activities, focused on its ability to detect compliance failures. In the case of relations with the client, it focuses on the possible suspicious activities of the client, rather than the fulfillment of the securities firms' obligations to the client. While this may sometimes be necessary, the inspection team should adapt its approach so that there is more attention paid to a broader analysis of the capacity of the securities firm to identify and manage its risks. The evidence from the private sector is that the inspection team is beginning to behave in this way, and this development is to be commended.

CBR have explained that the development of Russian legislation over the past thirty years has reflected the suspicion of members of the public and Duma about the possible abuse of power by state agencies. As a result, there is a reluctance to include the more general provisions suggested above. It is difficult to impose penalties on a firm where the firm has breached a general duty, rather than a specific requirement. Moreover, CBR has stated that it cannot take action to enforce provisions relating to conflicts of interest unless there is a specific case where a conflict of interest has occurred and resulted in loss.

The assessors appreciate that this difficulty imposes a constraint. However, it is clear that the IOSCO principle envisages the imposition of general duties on securities firms and the assessors are obliged to point out where the absence of such overriding duties in the Russian regime conflict with the requirements of the principle. Moreover, they would note that the practice in the laws on securities is developing. There are some areas, described above, where general duties are imposed of a more wide-ranging necessity—such as those in Article 10.1.1 of the Securities Law. The practice of CBR appears to be developing as well and there are clearly instances where the inspectors have engaged in helpful discussions with professional securities firms about their RM systems. These discussions are on the basis of an overall requirement rather than a specific rule.

The assessors have also noted that CBR is making a determined effort to clean up the securities market and remove those who may have received licenses in the past when they may not have

met the criteria. This is commendable and the results achieved in the first year of this new approach are striking.

Although CBR were unable to provide data on the number of inspections of professional securities firms, the overall numbers given in the annual report, if replicated for intermediaries would suggest that the number of scheduled inspections is insufficient to amount to an effective supervision regime.

The recommendations below are intended to encourage CBR to continue in the direction on which they appear to have embarked.

Recommendations

CBR should seek amendments to the Securities Law to impose the following obligations on securities firms, in each case, with overall provisions supported by some detail giving clear information about what is required to ensure that the overall obligations are implemented effectively:

- To act with due care and diligence in the interests of a client, to place the interests of the client above its own, and to have systems and controls that ensure the integrity of its dealing practices and the fair, honest, and professional treatment of clients;
- The management to have full responsibility for complying with legal and regulatory obligations;
- The management to undertake a RM of its business, to devise policies and procedures that address those risks, to train staff in those procedures, to have an information system for assessing effectiveness of those policies and procedures, to review the effectiveness at least once a year, and to reassess the risks at least once a year;
- An investment manager to hold client funds in a segregated account;
- All securities firms to identify and prevent, or manage conflicts of interest—by disclosure, internal organizational barriers or by declining to act;
- All securities firms to ensure that there is appropriate segregation of duties where necessary to prevent unmanageable risks of conflicts of interest, undetected errors, breaches of internal controls or abuse more generally;
- All securities firms to obtain sufficient information about the client’s circumstances and objectives to enable them to provide appropriate services and advice;
- All securities forms to refuse to accept clients where the reasonable and affordable measures have not identified the beneficial owner and to establish in each case if a natural person is acting on his or her own behalf or on behalf of another;
- Those firms that hold client money to reconcile client money in the bank accounts with the internal records on a daily basis; and

	<ul style="list-style-type: none"> • Those firms that hold client assets to have effective protection for those assets including segregation and a requirement to reconcile client assets with internal accounting records weekly for high intensely trading clients, monthly for all other clients except those who do not trade for three months, whose reconciliation should be quarterly. <p>CBR should amend regulations to impose the following obligations:</p> <ul style="list-style-type: none"> • To have systems and controls to limit the use of client money in the securities firm's own interests (to circumstances where it provides scope for covering temporary and minor shortfalls in the client account), to give prominence to this matter in the client agreement, to explain the risks to the client; • To identify all clients and the beneficial owners; • To provide a client with a written agreement with certain specified contents, such as fees and charges; and • To give a client enough information to make an informed investment decision.
Principle 32	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	<p>CBR has various powers to deal with a professional securities firm that is going into default.</p> <p>In particular, the Insolvency Law has a chapter on the bankruptcy of financial organizations, starting at Article 180. This includes professional securities firms and management companies. Article 183 and following gives authority to CBR to take a variety of actions.</p> <p>Under Article 183, it is for the financial organization itself at first to take action when certain conditions are met. This action includes obtaining more capital or financial aid from the founders, reorganizing (which means cutting costs, reducing departments, realizing or changing the maturity of assets—Article 183.3) or other measures. The action must be included in an action plan sent to CBR within 15 days of the conditions being met. The plan to be completed no more than six months from the date when the conditions are met.</p> <p>The conditions that require action to be taken are (Article 183.2): (i) refusal for a month to meet creditors' claims; (ii) being 10 working days late with a payment; and (iii) inadequate funds to make a payment when due. These conditions amount, in effect to a default.</p> <p>On receiving the plan, CBR must decide whether or not to appoint an administrator within 30 days. It must conduct an inspection.</p> <p>If CBR detects the conditions identified above but receives no plan, it can appoint a provisional administrator. It can also do this if the plan is inadequate or not implemented (Article 183.5). The appointment must be announced.</p>

	<p>Article 183.6 says that the purpose of the administrator is to restore solvency and safeguard property. Article 185.2 also says that an administrator must safeguard client assets. Article 185.2 obliges an administrator to take care that the special client accounts contain enough to meet liabilities to clients. However, it does not say what to do if there are shortfalls in those accounts, except that Article 185.5(3) states that property is distributed pro rata. The unpaid pro-rata amount is then included as a creditor claim</p> <p>The administrator can take measures designed to prevent bankruptcy. Article 183.7 states that the administrator’s orders must be followed without fail by employees. It can also go to court to invalidate transactions. Article 183.9 gives CBR the right to suspend the authority of the management bodies if the management did not report the conditions to CBR or failed to implement a plan. If management is suspended, they can only make certain transactions when authorized by the administrator (Article 183.9)</p> <p>The administrator cannot be a member of CBR (Article 183.6(7)(5)). But the CBR can send a representative to exercise control over the administrator (Article 183.6(11)).</p> <p>Under Article 183.11 the administrator can take a decision to liquidate or go into receivership (see Article 183.13). Article 183.12 makes clear that an administrator cannot operate for more than 9 months unless there is a liquidation or receivership.</p> <p>Article 19 of the Law 46 on Investor Protection (the Investor Protection Law) provides the scope for an investor compensation fund. However, no such fund exists.</p> <p>CBR has no contingency plan for dealing with the failure of a securities firm. They noted that there had been no such failure in twenty years, although they gave examples of actions that had been taken with firms which may have come close to default.</p> <p>There is no information on other procedures that might be taken as part of such a contingency plan, such as communication or cooperation with other regulators.</p> <p>There are no early warning systems or other mechanisms to give notice of a potential default beyond the monthly and quarterly financial reports to CBR.</p>
<p>Assessment</p>	<p>Not Implemented</p>
<p>Comments</p>	<p>The rating is given because:</p> <ul style="list-style-type: none"> • There is no clearly documented plan for dealing with the failure of an intermediary, therefore no evidence of such a plan being tested regularly and no evidence that CBR has the practical ability to take action; • With no credible plan, there is no procedure, within that plan, for cooperation with other domestic and foreign regulators;

	<ul style="list-style-type: none"> • There are no early warning systems of potential default, if capital deteriorates rapidly since the last monthly or quarterly financial report. There is no obligation on a professional securities firm to report reductions in capital or capital levels that are close to the minimum; • CBR has powers to take action but these can mostly only be deployed once a professional firm is already in default. <p>Recommendations</p> <p>CBR is recommended to seek changes to the Insolvency Law that would enable it to appoint a provisional administrator if it thought such action was necessary to protect investors or safeguard market stability from the consequences of a default. It should be possible to use such powers when CBR considered that there was a realistic prospect of imminent default and that action was necessary to prevent it. CBR should review the powers of the provisional administrator to ensure that they are sufficient to enable it to:</p> <ul style="list-style-type: none"> • Restrict activities by the intermediary; and • Move client accounts to another intermediary; • Apply other available measures intended to minimize customer, counterparty, and systemic risk in the event of intermediary failure, such as customer and settlement insurance schemes or guarantee funds. <p>It is further recommended that CBR draw up a detailed plan of the specific actions it would take in the event of a failure, including the names and contact details of those who would take the relevant decisions, contact details of the relevant people in other agencies, draft press releases and statement to investors, check lists of steps to be considered to exercise legal powers and protect investors, lists of the necessary physical facilities that may be required, names of possible administrators and other relevant matters. The plan should be tested from time to time in a trial exercise.</p> <p>The recommendations made above in Principle 29 regarding the power to place a condition on a license is also relevant here as such a power could be used to take early action before the administrator is appointed.</p>
Principles for Secondary Markets	
Principle 33	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	The setting up and operation of an exchange or trading system is governed by Federal Law No. 325-FZ of November 21, 2011, On Organized Trading (the OT Law). Since January 2013 CBR received applications for an exchange license from 13 organizations. Licenses were granted to nine organizations (one to the Crimean exchange (for trading agricultural products, raw materials, and food supplies for professional organizations) and eight to existing exchanges).

	<p>Four applications were denied. All those which were refused a license were planning to organize commodities trading.</p> <p>In December 2011, an exchange was established by the merger of the two largest exchanges, the MICEX and the Russian Trading System (RTS). The merged entity trades as the Moscow Exchange and has a near monopoly on equity, bond, financial derivatives and foreign exchange trading. Under the OT law it was relicensed. The holding company went public in February 2013 and raised RUB 15 billion. The group is listed on the exchange.</p> <p>Relicensing was required because under the OT Law setting up and operation of an exchange or trading system requires a license. Since September 2013, the licensing authority is CBR.</p> <p>Article 1.7 of the OT Law defines organized trading as trading carried out regularly by rules which define the procedure for admitting persons to trading and to enable them to enter contracts for the purchase and sale of goods, securities, foreign currency, repo contracts, and contracts which constitute derivative securities. Pursuant to Article 5.1 organized trading may only be performed by a company that is registered as a legal entity according to Russian legislation. Article 5.2 prohibits a person without a stock exchange or a trading system license from holding any organized trading. Previously, exchange licenses were issued for specific markets. Under the OT Law a single license is issued. Requirements are the same for exchanges providing trading in different sectors, but exchange rules should be specific to each sector and take account of the differences in markets. There are special criteria for the various possible derivatives markets sectors. In total, there are nine exchanges licensed in the Russian Federation. There are only five clearing houses that are licensed. The NCC is the biggest and that is part of the Moscow group.</p> <p>Brokers can internalize order flow, but in practice none are doing so in the Russian Federation as far as CBR is aware.</p> <p>The OT Law sets out extensive requirements that an applicant exchange is required to meet, with respect to:</p> <ul style="list-style-type: none">• its corporate form;• the fitness and properness of the shareholders, especially as regards significant shareholders (those owning 5 percent or more of the voting shares of the company, individually or jointly);• organizational structure (an exchange cannot be a clearinghouse but there can be a clearinghouse in the same group);• key personnel including the CEO, supervisory and executive board members, head of the internal supervision service, the chief accountant, and the official responsible for the management of the risk control system;
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- minimum capital of RUB 100 million (RUB 50 million for a non-exchange trading system), where the composition of that minimum capital has been set by CBR rule and varies based on the type of trading activity undertaken;
- detailed trading rules appropriate to its markets;
- procedures for setting up both the organized trading, monitoring, and supervision of trading participants, listed companies (if relevant) and other relevant persons as required by the law (e.g., Federal Law 224-FZ of July 27, 2010 on countering the illegal use of inside information and market manipulation).

There are no provisions in the law that require or permit CBR to exercise judgment on whether or not to license an exchange based on some form of economic or other analysis of the market the exchange intends to serve. It must apply only the requirements set out in the OT Law.

The applicant exchange is required to submit a substantial volume of documents from which CBR assesses the applicant's compliance with the requirements of the law and its competence to operate a secondary market according to its business plan. CBR establishes general requirements for a number of procedures, including management of operational risk, and can give recommendations and orders and impose conditions. It also meets with management of the exchange during the application process. Moreover, since January 1, 2016 a preliminary examination process was introduced for an applicant by License Instruction 169-I dated October 26, 2016.

Article 26(2) of the OT Law empowers CBR to impose conditions on an exchange or trading system on matters including trading rules, procedure for setting up both trade monitoring and supervision of participants in the trading and other person, and the organization of internal supervision measures aimed at reducing risks in trading.

In the case of the Moscow Exchange, in recognition of its near monopoly position in several markets, special conditions were applied on free access by professional market participants (for example for former RTS market members) and on the composition of the statutorily mandated Exchange Council to ensure that members had an appropriate voice in decision making. The exchange's arbitration process for members subject to sanction, which it operates in conjunction with NAUFOR, the SRO for professional market participants, was reviewed. The exchange is not an SRO under the SRO Law.

The OT Law provides powers for CBR to deny a license (Article 26.2) and to revoke a license (Article 28) in defined circumstances.

Detailed assessment of an exchange's operations is made by CBR pursuant to RF FSFR Order No. 13-53/pz-n of June 25, 2013 which established requirements for an exchange with respect to the organization of the RM system and internal control procedures, including documentary support.

In considering its license application, all elements of the MOEX's processes and procedures were reviewed including its technical standards, backup provisions, etc. As regards fair access, MOEX has a Department of Access to Trade. This is an independent unit that evaluates and assesses candidates for membership in line with the rules. That same department will follow up to ensure that members comply with the rules and it handles discipline. Its operation is subject to CBR oversight.

The exchange is required to be able to demonstrate that it can supervise to ensure that:

- a trading participant meets the requirements defined in the exchange's trading rules, and these rules are followed by the participants and other persons;
- securities and their issuers that are accepted into trading meet the requirements defined in the exchange's rules;
- the issuers and other persons meet the terms and conditions of contracts based on which the securities were admitted to trading; and
- transactions performed on the exchange are supervised and recorded with the objective of prevention, detection, and suppression of unlawful use of inside information and/or market manipulation.

These requirements include conducting inspections of its members on its own behalf and at the request of CBR.

As a condition for granting a license to operate, an exchange is required to demonstrate to CBR's satisfaction that it has effective mechanisms to identify transactions which violate participants' rights and the integrity of the price formation process and if necessary to suspend or terminate trading in specific securities or derivatives contracts, groups of securities or the whole market. Clause 1.15 of CBR Regulation No. 437-P of October 17, 2014, on organized trading sets out in substantial detail the circumstance in which trading must be suspended including detailed requirements for circuit breakers (e.g., on a 20 percent price move within a 10-minute period). The mechanisms must be sufficient to enable the exchange to meet its obligations under Clause 1.16 of 437-P that requires it to carry out the monitoring of the organized trading, as well as control of the trading's participants and other persons with a focus on so-called "non-standard" transactions (NST), which suggest market manipulation or the misuse of inside information. In order to meet these requirements, the exchange must install an automated system for monitoring trading which ensures continuous tracking by the exchange of prices, amounts and other characteristics of trades and contracts (Clause 1.19) and ensures that it is possible to create an audit trail of transactions when necessary. The exchange is required daily to transmit to CBR data on all NSTs detected during the previous trading day.

In practice, disciplinary cases against exchange members for a range of offenses under its rules that fall short of making an NST (which requires consideration and possible investigation by the CBR) are not frequent. In 2015 ten members were disconnected from NCC clearing (which effectively amounted to expulsion from the exchange since all members must be clearing

members) although it is unclear whether that was a consequence of a prior license annulment by CBR. One fine was levied, for breach of business ethics, and no warnings were issued.

MOEX has a listing department that oversees admission to trading by issuers. This department also oversees compliance with listing rules. The main continuing disclosure obligations are written in general securities regulations and MOEX does not add significantly to these requirements. But MOEX has rules that relate to foreign securities that are not covered by Russian regulations. There are additional disclosure requirements for certain products, for example, mortgage certificates. MOEX monitors compliance with CBR disclosure rules and timing of reports. They issue notices to listed companies in order to check whether non- or delayed-disclosures were material.

In practice it appears that breaches of the disclosure regime are rarely subject to direct sanction, although on a quarterly basis a company's position in one of three quality grades for equities is reassessed. Breaches of the disclosure regime are taken into account in such reassessments, although the primary determinants are the level of free float, compliance with IFRS in financial reporting and standards of corporate governance. Stocks are rarely suspended except in extreme circumstances. Typically, the company notifies the exchange that it has an issue and the exchange merely notifies the market of this. Investors are permitted to make their own decision as to whether or not to continue trading, although a sharp price movement may generate a trading halt under the circuit breaker rule.

The exchange supervisor team of CBR comprises six people, including several with experience of working in an exchange who are capable of making the necessary assessments. They are supported as needed by the staff of the Department for Combating Malpractice which has 40 staff. In the course of ongoing supervision, Article 25.3 of the OT Law gives CBR unrestricted access to the exchange's facilities and if necessary, to other entities providing services to the exchange under a service contract or entities which accommodate the exchange's hardware or information storage facilities. This includes access to members' trading records held by these entities.

Extensive regulatory provisions cover the obligation on an exchange provide CBR with information on securities and contracts to be traded on the exchange. See CBR Regulation No. 428-P of November 8, 2014, "On Standards for the Issuance of Securities, Procedures for State Registration of an Issue (Supplemental Issue) of Issue-Grade Securities, State Registration of Reports on the Results of an Issue (Supplemental Issue) of Issue-Grade Securities, and the Registration of Securities Prospectuses," and RF FSFR Order No. 13-62/pz-n of July 30, 2013, "On Procedures for the Admission of Securities to Organized Trading." Article 25.1(10) of the OT Law sets out the power of CBR to set the requirements for contract specifications of derivative contracts. There is a regulation on this issue: Ordinance of FFSM N 13-58/pz-n On Adopting Requirements of the Specification's Content of the Derivative. CBR requires an exchange will take product design, market conditions and the requirements of the law into consideration when introducing a new product, but the decision is the exchange's.

	<p>Fairness of order execution procedures</p> <p>Conditions of trading are non-discriminatory. All rules and procedures are disclosed by an exchange on its website pursuant to Article 22 of the OT Law. Chapter 3 of the law addresses the execution of orders and making of contracts on the exchange. In addition, those issues are enforced by CBR using its powers under a CBR Regulation on Organized Trading.</p> <p>The trading rules of an exchange rules (and changes thereto) must be offered to the members for consultation before being approved and sent to CBR for registration and approval. The registration procedure of the internal documents (rules, specifications) and their modifications of the organizations that already have a license as an exchange or trading system is set by CBR Note 3546-Y dated May 24, 2015. Within MOEX there are advisory panels of members in each market sector to provide views and advice. CBR will investigate any complaints alleging unfair application of the rules. Confidentiality is a statutory requirement. For example, Article 22. 5 of the OT Law requires that the trade reporting and disclosure systems must be able to publish the required information such as bids, offers and completed trades while maintaining confidential the identities of the brokers and clients engaged therein. Chapter 4 of Regulation 437-P sets out detailed system and procedural requirements for maintaining the confidentiality and security of data kept by the exchange. The exchange is required to maintain a full record of all orders entered onto its systems and trades executed thereon (full audit trail).</p> <p>The obverse of the confidentiality requirements are the general provisions on disclosure. Article 22 also sets out detailed disclosure requirements:</p> <ol style="list-style-type: none"> 1. The organizer must ensure free access to the information identified in this article for all persons interested therein whatever the purpose for which such information is obtained. 2. The organizer must ensure disclosure of the following information and documents: <ul style="list-style-type: none"> • its own constituent documents; • rules of organized trading; • Regulations of and decisions of the Exchange Council; • annual reports of the exchange enclosing an audit opinion regarding the annual accounting (financial) reports contained in annual statements, and also with regard to the consolidated financial reporting contained in the annual statements; • the amount of fees charged for services provided by the organizer of trading; • the trading times; and • other information that is to be disclosed under the law and regulatory acts of CBR. <p>As to the trading system technology itself, CBR has expertise to examine the trading algorithms and other aspects, and has done so in the case of the MOEX foreign exchange market when volatility in that market was a concern. MOEX offers various connection options with various speed at a range of prices. The performance statistics are freely available. Co-location is also</p>
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	<p>offered. Direct Electronic Access can be offered to clients by exchange members. The exchange (using NCC) offers an automatic pre-trade clearance check based on individual client limits, or the member can use his own systems for risk control. The real time transparency offered by MOEX facilitates this latter option.</p>
Assessment	Fully Implemented
Comment	<p>As is typical of most jurisdictions, applications to open a new exchange or non-exchange trading system are rare events. As a result, licensing procedures may not be current and regulatory staff with direct licensing experience may not exist. Despite these handicaps, from discussion with exchange supervision staff at CBR it was apparent that the licensing of the merged MICEX and RTS was thorough and skillful and the review was performed with an awareness of significant issues.</p>
Principle 34	There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	<p>MOEX and the other (much smaller) exchanges provide CBR with remote terminals, which give CBR a real time feed of all entered orders and completed transaction as is available to all member of the exchange. Additionally, the exchanges provide CBR with a next day feed of additional data on trades including all trades identified as NSTs using the exchange's criteria. These criteria include:</p> <ul style="list-style-type: none"> • A set value of deviation of the order price from the closing price of the previous trading day; • A set value of deviation of the price of an order from the price of the last order; • A set value of deviation from the current price of a current order; • Unusual deviation in the main stock index; and • A set value of deviation in the volume of organized trading for a certain period. <p>The criteria that the exchange is using is not disclosed to the members. CBR also applies different criteria for NSTs and compares results</p> <p>Transactions data is also received in real time from depositories for OTC transactions.</p> <p>The Department for Market Manipulation uses a third party software package called "Forecast: The Electronic Dossier" and is constantly working on improvements. As of February 2016 it had completed work on the implementation of a service pack, which provides advanced features for the visualization of data on exchange trading, with automatic alerts, and an analysis of related accounts. The department is also building a situation room in which all transactions from all exchanges will be brought to a single database and this will involve a major upgrade. The current need for multiple screens makes tracking cross-exchange manipulation sub-optimal.</p>

CBR is empowered to use both onsite inspections (routine and “for cause”) and offsite reviews of an exchange. CBR has not yet carried out an onsite inspection of an exchange. The inspectorate is now augmenting its staff to be able to undertake exchange inspections and only recently has said that it is ready to do an inspection. At present CBR is planning for an inspection of a small exchange. This will be Moscow Energy Exchange that trades energy based derivatives. This will be a practice to enhance capacity of the inspection team before tackling MICEX. Although the exchange supervision team recognize that some work has to be carried out onsite, such as some aspects of verifying the robustness of IT systems, it believes it can achieve a lot via its offsite work. It is also an observer on the MICEX member committees (CBR is an active member of the Exchange in the repo and FX markets) that gives it the ability to stay in touch with member views and concerns when they arise.

All exchange rule changes have to be approved by CBR. Legally, MOEX must give five days’ notice to members of proposed rule change. In practice, it gives them longer as it works through committees. CBR, as a trader on the exchange is a participant in committees of the exchange. According to CBR, participation in committees allows CBR to receive information on problems and concerns of the market participants and to take supervisory measures when necessary.

In addition to quarterly financials and trading information, an exchange must give CBR information on new and departing members, all disciplinary cases, stress testing results, and information on technical malfunctions. Recent problems in this last regard have required MICEX to agree a program of improvements with CBR.

Every two years MICEX is required to undergo an operational (IT) audit and to share the results with CBR. The audit generally contains recommendations for improvements and CBR follows up to ensure that MICEX implements them.

MICEX produces some special challenges for CBR. The Moscow Exchange Group, of which MOEX is a part, is a public company listed on the MOEX exchange. It is required to comply with all the requirements of a listed company including the disclosure regime and corporate governance requirements, which its subsidiary, MICEX, is required under the law and supervision of CBR to enforce. As a near monopoly provider of financial markets in the Russian Federation, CBR may find it particularly difficult to enforce any particular requirement on MICEX if the exchange does not believe it to be in its best interest, although as a central bank, it may find this somewhat easier than the FSFM would have done.

If CBR discovers that an exchange is in breach of the law or regulatory acts of CBR, there is a range of sanctions and restrictions that it can impose (Article 25 of Law). As with other licensed entities, CBR is empowered to identify and list the deficiencies and set deadlines for their correction. There are also administrative penalties. An exchange can be fined for a breach of its own rules as happened to MICEX several years ago when it was fined by the CBR’s predecessor body for a failure to exercise control over a member. There is also the right of CBR to suspend

	operations in full or in part. Under Article 28 CBR may revoke the license of an exchange or trading system and the article sets out the grounds for revocation.
Assessment	Partly Implemented
Comments	<p>Although the elements of supervision as set out in this principle appear to be met as far as this can be achieved from the obligation on exchanges to provide substantial ongoing documentation flows to CBR, the system of supervision has yet to be rigorously tested by an onsite inspection of MOEX, a period of intense stress in the markets, the unexpected insolvency of a major listed company or the failure of one or more large members. Although CBR has the right to suspend the operations of MOEX and to revoke its license, its near monopoly position makes this a theoretical rather than a practical power, as is not unusual in many jurisdictions.</p> <p>The downgrade results from two issues:</p> <ul style="list-style-type: none"> • First is the current lack of a currently operational onsite inspection program for MOEX and the other exchanges licensed by CBR. There is clear evidence that a program is in an advanced stage of planning. The first (small) exchange, to be used to test and fine tune the adopted approach, has been selected. Subsequently the first inspection of MOEX will be an important stage in CBR's development as a securities market regulator and it will be critical that the inspectors have the necessary skills and will have been fully briefed by the offsite exchange supervision team to carry out their task efficiently and knowledgeably. • Second, in considering issues which arise in its ongoing supervision of MOEX the exchange supervision team should look carefully at the exchange's record of disciplining members and listed companies. The approach has elements which, while it may be effective in the context of a Russian market with few retail investors, are difficult to reconcile with good international practice. Looked at from an investor protection perspective, MOEX seems to place a degree of reliance on "caveat emptor" which in the last two decades has been replaced by stricter enforcement of rules in other major exchanges subject to regulation by a statutory regulator.
Principle 35	Regulation should promote transparency of trading.
Description	<p>The provisions which mandate the required level of transparency for on-exchange transactions are found in paragraph 1 of Appendix 4 to the Regulations of CBR № 437-P from October 17, 2014 "On activities for the organized trading" and cover pre- and post-trade transaction details.</p> <p>MICEX operates several markets in shares, government and corporate bonds, derivatives, foreign exchange and repos. It has combined traditional on-exchange trading with facilities that encourage markets that are generally carried on OTC in other jurisdictions, to trade via its facilities. In the case of listed equities, it maintains separate markets for its computerized limit order book and for equities with bilateral trading of large orders in the same securities. The</p>

	<p>trades are displayed separately, with times, so that the market can see the trades but can recognize that they did not form part of the price formation process in the limit order book.</p> <p>The exchange is required to publish the bids and offers (price and size) it receives on its limit order book (where most equities trade) up to the twenty 20 best bid and offers for each security traded on the system. This information is made available to its members in real time during the trading day. Clients who require real time prices can also get access for a fee. The same arrangements apply to completed trades. Retail investors can see trade prices on the exchange's website for free with a 10-minute delay.</p> <p>There are no dark pools in Russia and the only (partially) dark orders are iceberg orders on MOEX which conform to standard regulatory requirements: once the first disclosed portion has been executed, the second portion is displayed but is placed behind, in time priority, any other orders at the same price. A MOEX experiment with a dark pool facility did not attract support.</p> <p>MOEX's trading rules are accessible to the public via its website.</p> <p>OTC trades not executed on the exchange must be reported to the exchange within 15 minutes of execution for publication or, if at the end of the day, at least one hour before the exchange opens the next day. Very large OTC trades can be subject to delayed publication for up to 30 days.</p> <p>CBR has full access to all order and trade data. As described in Principle 34, the exchanges provide CBR with real-time remote terminals which provide full information on trading conducted during the course of the day including bids and offers and completed trades.</p>
Assessment	Fully Implemented
Comments	There appear to be no obvious omissions in the transparency regime on markets operated by MOEX and the other exchanges. The unusual ability of the exchange to have developed markets in products largely traded OTC in other countries such as corporate bonds, foreign exchange, and repos means that there is more transparency in these markets than is typical elsewhere. The absence of dark pools, even informal ones such as broker crossing networks (except for offshore business), means that a factor which elsewhere complicates initiatives to maintain or increase levels of transparency in equity markets and limit the creation of two-tier markets is missing. HFT is significant in equity trading however.
Principle 36	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	Insider trading and market manipulation are dealt with in Federal Law No. 224-FZ of July 22, 2010 "On countering the illegal use of inside information and market manipulation" (IT Law). Prior to that, Russia had no legislation or regulation of these abusive activities. Its passage through the State Duma was controversial. Administrative sanctions were introduced later, and criminal sanctions after that, in order to give professional market participants and others time to get used to the concept and the new risks to which certain trading practices were exposed.

To prove that a criminal offense has been committed it is necessary to prove intent. For administrative offenses that is not necessary.

Article 5 set out numerous examples of activity which it defines as defines market manipulation such as trading to maintain the price of a security at an artificial level and so called “pump and dump” schemes. It also includes the dissemination of misleading information. Article 6.2 of the law prohibits market manipulation. Article 5.3 provides exemptions from the market manipulation offense for activities such as the “stabilization” of the price of new issues of securities and maintaining the price to facilitate a share “buy back” program. Further detail is provided in Regulation No. 11-2/pz-n, 2011 of the FFMS: terms and procedure for maintaining price, demand, supply and trading volume of financial instruments, foreign currency and (or) commodities.

Article 2. 1 of the IT Law defines inside information as an exact and specific piece of information which has not been disseminated or provided, whose dissemination or provision can substantially affect the prices of financial instruments, foreign currencies and/or commodities (for instance information concerning one or several issuers of shares). Article 3 sets out the information which is deemed inside information such as commercially confidential information and information gained in the course of inspections/audits. It is not necessary to have a fiduciary relationship or a relationship of trust with the issuer to commit the offense. However, Article 4 sets out a substantial, but non-exhaustive, list of persons, legal and natural who are deemed to be insiders. It includes persons who have access to inside information on, for example, a company, as a result of contractual arrangements such as auditors, valuers, professional participants in the securities market, banks and insurance companies, members of a company’s board, participants in a takeover bid, credit rating agencies and certain state employees. Article 6.1 prohibits the use of insider information and includes a prohibition on “tipping off” another person.

Front running, or trading by a market professional ahead of a client’s order is an offense. Knowledge of a large client order would be inside information. There are concerns in CBR that this offense is difficult prove even at an administrative level as there may be too many alternative explanations (defenses) as to why the professional market participant traded in the particular stock at the particular time. CBR can go to court to support a client’s claim for compensation for loss in such cases. Loss may also be difficult to prove.

Other similar offenses and securities market fraud are covered by the Criminal Code.

Detection and deterrence mechanisms

CBR employs a number of mechanisms the intention of which, in whole or in part is to detect and deter abusive behavior. Most of these are referred to in other principles:

	<p>MOEX and the other exchanges provide CBR with remote terminals, which provide a real time feed of all entered orders and completed transactions. Additionally, the exchanges provide CBR with a next day feed of additional data on trades including all NSTs (Principle 34).</p> <p>CBR expects that the exchange will take product design, market conditions and the requirements of the law, (including the IT Law) into consideration when introducing a new product. Article 25.1(10) of the OT Law sets out the requirements for contract specifications of derivative contracts (Principle 33).</p> <p>Large exposure and other position monitoring may provide useful information (Principle 36); audit trail requirements on exchanges (Principle 33) and market participants (Principle 33) can also be utilized; client preference requirement (Principle 34) are relevant, and real time publication of on-exchange orders and transactions (Principle 35) provides transparency to CBR and market users. However, the very limited use of trading halts and suspensions by MOEX (Principle 34) limits the information content of these tools and therefore their effectiveness.</p> <p>The mechanisms must be sufficient to enable the exchange to meet its obligations under Clause 1.16 of Regulation 437-P which requires it to carry out trading monitoring as well as control of the trading participants and other persons with a focus on NSTs that suggest market manipulation or the misuse of inside information. In order to meet these requirements, the exchange must install an automated system for monitoring trading which ensures continuous tracking of prices, amounts, and other characteristics of trades and contracts (Clause 1.19), which it has done.</p> <p>Sanctions</p> <p>Article 185.6 of the Criminal Code of the Russian Federation was introduced into the Russian Criminal Code by the Insider Trading Law and establishes criminal liability for the unlawful use of inside information and market manipulation. It became effective on July 30, 2013.</p> <p>Under Article 185.3 of the Criminal Code of the Russian Federation market manipulation involving large losses to others or large profit or avoided loss (in excess of RUB 2.5 million (US\$37,000) is punishable with a fine in an amount from RUB 300,000 to RUB 500,000 or one to three years' salary or imprisonment for a term of up to four years with a fine in an amount of up to RUB 50,000 (or up to three months' salary) with subsequent restrictions on professional activities for up to three years. In particularly serious cases involving a group of individuals or very large losses to others or very large profit or avoided loss, (in excess of RUB 10 million), the fine may be from RUB 500,000 to RUB 1,000,000 or two–five years' salary or imprisonment for a term from two to seven years with a fine in an amount of up to RUB 100,000 (or up to two years' salary) with subsequent restrictions on professional activities for up to five years.</p> <p>Under Article 185.6 of the Criminal Code of the Russian Federation the illegal use of inside information involving large losses to others or large profit or avoided loss is subject to similar</p>
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criminal penalties and includes the offense of “tipping off” another person to make a transaction.

If an offense is not punishable under the criminal law, such as where intent cannot be established, action can be taken for administrative sanctions. Administrative fines are lower, for individuals ranging from RUB 3,000–RUB 50,000 under Articles 15.30 and 15.21 Code of Administrative Offenses of the Russian Federation. Administrative fines on legal entities are subject to a minimum of RUB 700,000.

Tracking and analysis

As described in Principle 34, the Department for Market Manipulation (35 staff) takes the data provided by the exchanges and employs a third party computer program to identify and examine suspicious trades or patterns of trading. Recent improvements provide advanced analytics. Further enhancements include developing a single database that can be displayed on a single screen.

Staff in the Department of Market Manipulation review the data, and also any additional information from other sources such as the media, complaints etc. and make a report. If the evidence is considered significant, the report goes to the first deputy governor in charge of financial markets who will consider whether to order a full investigation. If he agrees to an investigation, the case is handled by the department that then uses the CBR powers to obtain information from “any person,” including government authorities. The department may look at all trading activities of a person and may look for a pattern to see if it is systematic. Phone taps or accessing other communications media can only be done by law enforcement through a court order. This has not yet happened in practice. Official communications are exempt. Following an investigation, a further report goes to first deputy governor which report names the individuals concerned recommends the actions that should be taken. Various sanctions such as removing a qualification certificate, cancelling licenses, penalties, and orders will be taken by CBR.

Matters also can be referred to the MoI for action; the referral decision turns on the estimated size of the profits made. Estimates in excess of RUB 2.5 million are referred to the ministry. The MoI has a Department for Fighting Against Economic Crimes and recently set up, within that department, a separate unit (Division F) for dealing with financial crimes, a development that the Department of Market Manipulation at CBR considers to be a great step forward. This unit and the CBR’s department work closely together at a formal and informal level. The role of CBR is to carry out a pre-investigation. Division F requires the department to provide a clear description of the offense and to prepare a list of persons concerned and witnesses. Division F collects the evidence with ongoing advice from the department. The ultimate decision as to whether to refer the case to the prosecuting authorities is taken by another body, the Investigative Committee of Russia, which carries out its own investigation supported by Division F.

	<p>Since September 2013, the department has made 70 investigations (57 on market manipulation and 13 on insider dealing). Sanctions imposed include the license revocation of securities firms and the withdrawal of the professional qualification certificates of individuals. In at least one case information was passed to an overseas securities regulator. Details of the cases, the identity of the firms and individuals concerned and the sanctions imposed are published on the CBR website. Two referrals have been made to Division F (one very recently), but as of February 2016 there have been no criminal prosecutions for insider trading or market manipulation. The first one may go to court in the summer of 2016. The department is working on draft regulations to give the law greater practical application and is discussing with Division F how to fulfill its role in the most effective way.</p> <p>Cross market trading is not a significant feature of the Russian markets although if it occurs, CBR can monitor it via the exchange terminals described above and analyze the data obtained. For stocks co-listed overseas, e.g., in London and New York, CBR can use the IOSCO MMoU, to which it is a signatory, to share information with its counterparts overseas. Domestically, it has full access to commodities and commodities derivatives data on MOEX, St. Petersburg, and the other commodity exchanges as described in Principle 37.</p>
Assessment	Broadly Implemented
Comments	<p>While the fines are unlikely to be dissuasive, the prison sentences should have a high deterrent effect, though that may depend on persons contemplating insider trading or market manipulation considering that there is an unacceptably high possibility of being detected and convicted in a criminal court. To date there have been no prosecutions, successful or otherwise, on which to base such expectations. But this is a new law.</p> <p>In order to enhance the cooperation between the Department for Market Manipulation and Division F over the longer term the two parties could consider whether there are benefits in developing a MoU which sets out the responsibilities and expectations of both parties. The expectation must be that the work load will increase as knowledge and expertise and technical and analytical resources to detect violations increase.</p> <p>The regulation of price stabilization of new issues and share buy backs appear to be limited to disclosure of the fact that price support may take place, and at what price, (for up to three months in the case of stabilization of a new issue). There appear to be no further constraints on how stabilization can legitimately be carried such as a prohibition on stabilizing above the offer price or stabilizing only until the new issue has been fully distributed. Given that market manipulation is now a criminal offense, the exemptions in the IT law have particular importance. As is the case in the European Union under the Market Abuse Directive and in other jurisdictions, such as Japan and the United States, where the equity and bond markets are an important source of debt and equity capital, CBR should review the current regulation and consider what improvements are necessary to impose suitable limits on trading activities in order to ensure that investors' interests are adequately protected.</p>

Principle 37	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	<p>Monitoring of large exposures</p> <p>Within CBR, monitoring of large exposures is undertaken by the FSD. It uses several data feeds. The monitoring of large exposures is carried on, in the front line, by the NCC, which is the central counterparty for transactions in securities, derivatives, cash and foreign exchange. NCC has 99 percent of the market. Also it processes OTC derivatives but this business is currently small. NCC provides the FSD daily (in real time) with data on all open positions ranked by size against the name of the relevant entity. The FSD has its own software to compare the position's size with an entity's own funds. The largest entities in the markets are the banks, and FSD sends to banking supervision reports on bank-to-bank and bank to nonbank exposures. FSD also receives daily data from trade repositories (derivatives and repo, on-exchange and OTC) and from depositories (which securities are in which portfolio). A data feed from MOEX, which includes all member trades, provides further data for analysis.</p> <p>The primary purposes of FSD's monitoring of large exposures are (i) to assess the stability of the financial system; and (ii) to monitor the risk exposure of the NCC. But its third purpose is to use the data to inform the supervisory departments of CBR of any emerging negative trends including the preparation of reports on SIFIs and other major entities. For instance, it is concerned if an exposure equals or exceeds 100 percent of an entity's own funds. NCC regularly stress tests its exposure and CBR does so independently using its own parameters. The use in the markets of standardized client IDs enables supervisors, if necessary to track client business and to identify them via the NCC members.</p> <p>NCC in its own right has the power to take action to reduce its exposure by, for example, raising margin requirements. Failure of a clearing member to meet a margin call is immediately notified to CBR. If it is necessary to share information with overseas regulators, the assistance of banking supervision is obtained as they have direct contacts with other central banks. CBR has other administrative powers if a professional market participant fails to provide requested information.</p> <p>NCC rules and procedures are available on its website. It is in regular consultation with CBR.</p> <p>In 2015, amendments to the Federal Law No.7-FZ "On Clearing and Clearing Activities" empowered NCC to effectively segregate member positions from their client positions. The current legal structure meets the requirements for close-out netting of contracts under the International Swaps and Derivatives Association master agreements and the global master repo agreement of the International Capital Markets Association.</p> <p>Short selling on equity markets</p> <p>Short selling is permitted in the equity market on MOEX in liquid stocks. For example, as of Februar 15, 2016 short selling was not permitted in 1,539 securities out of 2,766 served by the</p>

	<p>NCC. NCC can also set a requirement that a sale of a security is possible only when it is 100 percent pre-deposited by this clearing member. Compliance with the requirements of this mechanism is carried out automatically in the NCC. In addition, NCC can set different initial margin rates for buying and selling assets thus having an additional effective tool to control its exposure to short selling by MICEX members and their clients. Otherwise, control over member activity is limited. The responsibility is on the broker to ensure that its clients comply with the 5 percent price limit rule. Short sales do not have to be declared to the exchange before or after the sale. NCC minimizes the risk of failed trades (settlement is on T+2) via an automatic borrowing facility from the holdings of large institutional investors. The broker provides cash as collateral and pays a penalty rate. There is no obligation on NCC to notify MOEX of the borrowing. Otherwise, control over member activity is limited. The broker can arrange to borrow stock bilaterally, in which case NCC will have no indication that the sale was short. The only constraint on unauthorized short selling is that the short can be in place for no longer than three days. After that, if NCC knows of the short, it will close out the position.</p> <p>Information about a short selling ban is provided to the clearing participant and CBR, and published on the NCC website (http://nkcbank.ru/fondMarketRates.do). There is no information provided to the market or CBR on amounts of short selling in individual securities.</p> <p>There are no exemptions for market making or other practices.</p>
Assessment	Partly Implemented
Comments	<p>With one exception, the regime to monitor large exposures appears comprehensive, well planned and managed. It uses multiple data sources, mostly in real time. Flows of relevant information to the appropriate departments within CBR work well and should generate warning signals in time for CBR and NCC to take appropriate action. FSD's threshold for concern—a single exposure which equals or exceeds 100 percent of an entities own funds—is too high and should be reduced, possibly to a maximum of 25 percent.</p> <p>Recent changes to the bankruptcy law and the associated clearing law, and the approval of these changes by the associations that represent the interests of major participants in global swaps, derivatives and repo markets are to be welcomed.</p> <p>The downgrade results from the general lack of effective controls on short selling of equities on MOEX, including the absence of a surveillance regime by MOEX and the lack of arrangements for providing information on short selling to market participants. CBR should work with MOEX to research good practice in other markets and adopt measures best suited to the Russian market. The assessor recognizes that NCC takes effective measures to protect itself from exposure to naked short selling by MOEX members and their clients which is one necessary element of the IOSCO requirements but is not sufficient to justify a fully or broadly implemented rating.</p>