XVI International Finance Forum NFA

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Session 'Russian money market in the era of transformations'

Executive Summary

Opening the session, **Igor Marich**, Managing Director for Sales and Business Development, Member of the Board, Moscow Exchange, moderator of the session announced it is planned not only to discuss money market issues, but also to present a broader view of the Russian financial market and its key issues.

At first, **Igor Marich** proposed to discuss challenges and opportunities caused by the massive arrival of retail investors, since it is the main factor in the development of the Russian financial market since 2020.

Valeriy Vaysberg, Head of Research, Region Group noted that 2020 was very interesting not only in terms of the inflow of funds from private investors to the financial market, but also in terms of the activity of the market itself. Attractive OFZ and corporate bonds yields, blue chips shares let the private investors receive good returns on their investments. He was also surprised by the fact that in Russia private investors outperformed the market, including the institutional investors, who were quite conservative and did not take big risks. **Valeriy Vaysberg** also noted that last year there was a large outflow of funds from bank deposits banks to finance lost entrepreneurial income, to invest in real estate and the financial market. However, calculations show that real estate and the financial market did not absorb the entire volume of the general public resources. According to **Valeriy Vaysberg**, the main questions for 2021 is where the free funds of private investors will be directed: to bank deposits or the financial market. The speaker stressed that in this sense the actions of the Bank of Russia are very important. If the Bank of Russia gradually increases the key rate, and this is accompanied by stock market growth, then a rapid increase in deposit rates will not occur, and the inflow of funds from the general public to the financial market will continue. If the key rate increase is more aggressive, the bank deposits market will win.

Igor Marich agreed with the previous speaker and cited the data of Moscow Exchange indicating that retail investors are actively entering the market for the last two years. The number of private investors on the Moscow Exchange doubled for the last two years and exceeded 10 million private investors. About 40 – 50% are active participants in the stock market, but the number of funds in brokerage and trust management accounts also doubled over the past two years and reached 6 trillion Rubles. In comparison with the 34 trillion Rubles on bank deposits it is quite insignificant, but private clients' funds on brokerage accounts showing outperforming growth rates. **Igor Marich** pointed the general expectation that the growth of the private clients on the financial markets will continue. He also noted that such expectation forms the challenges, which have been much talked about in more recent times: protection of private investors, which financial instruments should be available to different categories of clients, etc. Therefore, both the regulatory authority and the financial market industry, including the Moscow Exchange, pay special attention to improving the investment literacy of the general public by raising the awareness of such clients about the possible risks that they may face within the financial market. Concerning the active development of the exchange-traded funds and investment funds, **Igor Marich** passed the floor to **Oleg Yankelev,** Director General, AMC FinEx Plus LLC.

Oleg Yankelev began his speech with a brief comment that the increase of the key rate and the rate on bank deposits is unable to fundamentally change the trend of recent years when an increasing number of private investors get acquainted with the opportunities of the stock market. Then the speaker spoke about the cardinal change in the situation on the Russian pooled investment market over the past 7 years. In 2013, the awareness of market participants and investors about passive investment opportunities was extremely low, and there were no convenient tools for accessing the market. Thanks to a breakthrough in brokerage technologies in the last 2-3 years, convenient market access platforms have been launched, without which it is difficult to interest a mass investor in ETFs. In addition, the conditions of low rates and the C-19 pandemic pushed investors to search for new opportunities in the investment market. According to **Oleg Yankelev**, the exchange-traded funds, which appeared on the market as a financial instrument in 2018, does not yet possess all the characteristics that are commonly expected from an exchange-traded fund around the world. Russian asset management companies have the opportunity to significantly improve the quality of their financial products, but this process largely depends on the Bank of Russia (in terms of fine-tuning of the regulatory framework) and market infrastructure (primarily, on the effectiveness of special depositories). At the end of his speech, **Oleg Yankelev** expressed the

opinion on the risks that would entail the introduction of an unsponsored ETF admission: there will be regulatory arbitration between the management companies of mutual funds and foreign funds, and in general, this will become a time bomb for the entire industry, since if a "window" appears for an unsponsored listing, then the level of investor protection will fundamentally decrease, tax risks, risks of asset safety will increase, and at the same time there will be a gap between the primary market and the secondary ETF market. As a result, the ETFs will turn from an effective liquid instrument on the Russian market into a closed-end fund with corresponding premiums and discounts, which will push back investors. **Oleg Yankelev** expressed the hope that the next result is that Russia, as well as the rest of the world, will have a civilized process of admitting instruments, and Russian management companies will have incentives to invest in the development of systems for managing index funds, recruiting appropriate teams and improving their product line tools.

Pavel Kotov, Head of Securities Finance & Structuring, Managing Director, Renaissance Capital, continued the topic of the influence of the influx of retail investors on the financial market. Based on economic theory, the speaker expressed the opinion that the present moment is a transition to a new economic formation, during which the economy should be cleared of the means of production and drivers that have been in the lead over the past decades. **Pavel Kotov** noted that the increased interest of private investors in the financial market is associated not only with low rates in the economy, but also with the growing new technologies, new ways of communication between people, and creating new approaches to doing business. This economic phase is characterized by the adaptation of market participants, both on the side of its institutional representatives (by diversifying their business) and on the side of private investors (by looking for new directions for their investments, focusing on new points of growth in the economy, for example, technology companies) to these new conditions. According to **Pavel Kotov**, to create new product offers for clients on the Russian stock market, it is necessary to focus on two areas of its development: the development of the infrastructure for clients (improvement of the legal framework) and the technological transformation of the market (for example, super-products and super-applications that include complex offers for clients).

Igor Marich supported the opinion that the future belongs to complex financial products for clients and cited the opening of a financial services marketplace for retail clients as an example of the Moscow Exchange's work in this field (creating a technological proposal on a new regulatory basis for retail clients to manage their finances from one window).

At the moderator's instance, **Andrey Baranov**, Head of Trading, Rosselkhozbank, spoke about how banks are responding to the current trend when retails clients are transferring their saving from bank deposits to the financial market.

During his speech, he noted the following key points:

1) the deflux of private depositors to the stock market did not affect the liquidity of the banking system, since banks have a sufficient amount of assets, through which they can attract financing from the regulatory authority and other government bodies;
2) the banks' deposits rates do not always suit customers, so banks need to make changes to them, for example, to introduce floating rates deposits. As floating rate deposits would not only attract additional resources from private depositors but also help banks to reduce the high-interest rate risk they currently have on their balance sheets associated with an imbalance between their assets (loans issued at a floating rate, which now tends to increase) and liabilities (funds at a fixed rate, which they attracted, including from retail customers). Now banks neutralize this interest rate risk in two ways: they conduct hedging operations using derivatives or by attracting funds from liabilities at a floating rate. According to **Andrey Baranov**, floating-rate bank deposits will be widespread in the foreseeable future.

3) there is currently a significant trend towards risks in the stock market, retail investors who have received investment income from operations on it over the past two years will soon have a desire to fix it. **Andrey Baranov** expressed confidence that for this purpose there is nothing better than a bank deposit since its main advantage over the stock market is stability, urgency and guaranteed return at the end of the deposits' term.

Dmitry Kasatkin, Executive Director, Global Markets Trading Division, Global Markets Department, Sberbank voiced Sberbank's vision of the transformations taking place in the money market. According to the speaker, having an extensive client base, Sberbank strives to ensure that all of the financial products are extremely simple for the client (clear terminology, the ability to use Sberbank as a "one-stop-shop service" for investing), and for the bank - manageable in terms of the risks of these operations. **Dmitry Kasatkin** named derivatives transactions with private customers as an interesting tool that appeared thanks to regulatory innovations.

The next speaker of the session, **Nikita Teplov**, Head of the Division for Improving Regulation in the Financial Market of the Financial Market Strategy Department, Bank of Russia, spoke about the Bank of Russia activities in terms of the development of individual investment accounts (IIS). The representative of the Bank of Russia cited statistics confirming the successful performance of the IIS by attracting a mass retails investor to the stock market. He also announced the further development of the IIS type 2 by increasing the annual contribution limit up to 3 million Rubles; granting investors the right to partially withdraw funds in certain situations; the multiplicity of IIS. The State Duma Committee on the Financial Market has already sent out the relevant package of amendments to the necessary Federal Law for approval and expressed hope for the speedy adoption of these amendments. Next, **Nikita Teplov** focused on the Bank of Russia work on the creation of the IIS type 3, which is designed to attract targeted long-term investments. In addition, the Bank of Russia considers creating an educational IIS that would allow investors to purposefully accumulate funds for the children's education. At present, the Bank of Russia is working out the specific characteristics of educational IIS, taking into account international experience, and then will organize a consultation with the market participants. Concluding the speech, **Nikita Teplov** touched on the IIS for a mutual fund, which was pushed by market participants. IIS for the mutual fund will provide an opportunity for management companies of mutual funds to open IIS. Answering the question from the moderator, **Nikita Teplov** said that even though the overwhelming number of private investors use IIS type 1, the Bank of Russia does not plan to establish any restrictions on its use yet.

Then **Igor Marich** suggested exchanging opinions on the situation in the repo and money market, including the recent tendency to lengthen the duration of repo transactions, more active use of floating rates and the lack of liquidity on the market.

Valeriy Vaysberg considers the retail investor is not interested in floating rate instruments due to the uncertainty of its income bracket and low coupon. At the same time, if banks actively issue bonds with floating rates (with a premium to RUONIA), they will be able to exclude the interest rate risk and lengthen the maturity of deposits.

Igor Marich noted that retail investors are currently pursuing a strategy to buy-and-hold securities to maturity due to a lack of information and investment costs. He also expressed the opinion that retail investors will invest more in bonds shortly.

Oleg Yankelev noticed the pooled investments instruments allow investors with a small portfolio to obtain wide diversification and thereby reduce risks from disruptive market events. The upside interest rate cycle will provoke an increase in the retail investors' interest in the money market funds. **Oleg Yankelev** expressed confidence money market funds have great prospects and potential, in particular, in attracting institutional investors and government bodies.

Pavel Kotov pointed out two main directions in changing the market sentiment regarding the floating rate. On one side, the willingness of large market participants to accept the risk of the floating rate when attracting funding. On the other side, there is another trend associated with floating rates, which has greatly increased the friendliness of banks and brokers to financing transactions: the introduction of the RUSFAR benchmark by the Moscow Exchange has significantly increased the comfort of banks and brokers by removing the growing basic risk in other benchmarks, in particular, RUONIA. The speaker also noted the growing demand from clients for direct access to the Moscow Exchange, including repo with GCC and other types of the repo with CCP. **Andrey Baranov** agreed with **Pavel Kotov**, adding that a variety of movement trends of ruble rates is always a difficult moment for the market. Commercial banks do not care at what rate granting loans to clients since a wide market for hedging interest rate risk is open for them.

Igor Marich commented that the Russian market has been discussing the issue of more active use of floating rates for a long time and that we are on the verge of developing the interest rate derivatives market. One of the interesting points of the discussion is the discussion of which interest rate benchmark is most representative. **Igor Marich** expressed the opinion that most likely the Russian market is moving towards two benchmarks: RUONIA (unsecured rate) and RUSFAR (secured rate). These benchmarks are understandable for professional market participants, but there are different opinions regarding the possibility of offering floating rate instruments to retail clients. Corporate clients show more interest in hedging interest rate risk but mostly focus on the key rate.

According to **Dmitry Kasatkin**, the money market has been rigidly segmented over the past 2 - 3 years: there is physical liquidity and regulatory liquidity. Physical liquidity is short-term transactions for up to 1 month, the basis between RUONIA and the key rate is mainly influenced by the Bank of Russia through repo or depo auctions. It is a liquid market segment. Regarding regulatory liquidity, **Dmitry Kasatkin** voiced the problem of limiting the terms for brokers on repo transactions, which negatively affects their capital, and expressed gratitude to the SRO NFA for working with the Bank of Russia to resolve this problem.

Concluding the section, **Igor Marich** turned to its participants with a proposal to express their forecasts regarding the further development of the money market.

Andrey Baranov suggested that the key rate will rise to 5% by the end of the year. **Valeriy Vaysberg** noted the high level of uncertainty at the moment and suggested waiting with forecasts until May - June 2021, when there will be more certainty with the movement of the inflation rate. **Oleg Yankelev** suggested to retail investors diversify their investments in the face of such uncertainty to avoid the negative consequences of market dynamics. **Pavel Kotov** agreed with the forecast for the key rate by the end of the year of 5% or more. In **Dmitry Kassatkin**' opinion, the recent actions of the Bank of Russia to change the key rate were not unexpected for the market due to the good communication of the Bank of Russia with the market.