



SRO NFA Consultation Paper MosPrime Rate Reform



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INTRODUCTION

- (1) This consultation paper has been prepared by SRO NFA the Expert Council on benchmarks and rates for a public consultation for the following purposes:
 - Attract the attention of market participants to the MosPrime reform;
 - Ensure transparency of the MosPrime reform process;
 - Determine the point of view of market participants on various aspects of the reform to support the ongoing work and verify the proposed solutions;
 - Involve new participants in the work, including non-credit financial organizations, non-financial organizations (corporations), and foreign organizations;
 - Search for alternative scenarios of actions and/or alternative points of view on the issues discussed.
- (2) SRO NFA invites interested organizations to send responses in any convenient form, while the most effective and convenient for processing will be responses that meet the following criteria:
 - A response contains answers to the questions asked in this document in accordance with the document structure;
 - Answers are accompanied by arguments in support of the expressed point of view;
 - In the absence of an unambiguous position on a significant issue, this should be indicated explicitly, absence of an answer means low significance of the question;
 - If the questions or information provided in the document are not exhaustive, then additions and alternatives are detailed in the response.
- (3) Replies can be delivered by e-mail info@nfa.ru until October 31, 2021 inclusive. Please, specify in the body of the letter or text the contact persons for communication in case that contents of the response needs to be clarified.

Document Structure

Section I describes the key initiatives and directions in the global benchmark reform. The section describes in detail the implemented methodological changes for foreign IBOR benchmarks (LIBOR, EURIBOR and TIBOR), which are analyzed and considered as a model example when discussing the MosPrime reform.

Section II describes the external (*associated with the global reform of benchmarks*) and internal (*specific to the Russian market*) factors that should be taken into account when setting the task of the MosPrime reform. The purpose of this section is a correct and complete description of the factors highlighting the most significant ones.

Section III provides information on the nature of the use of MosPrime in financial instruments and describes the current system of Russian benchmarks.

Section IV describes the MosPrime reform scenarios, which constitute many possible solutions. The purpose of this section is to correctly describe the expected result and risks for the current users of MosPrime, as well as to analyze international practice for each of the scenarios.

Section V provides assessment criteria for finding the best-case scenario. The purpose of the section is to correctly formulate the reform task, which determines the set of applicable assessment criteria and the choice of the optimal scenario.

EXECUTIVE SUMMARY

The MosPrime Rate benchmark (hereinafter referred to as MosPrime) is a Russian representative of the IBOR benchmarks family with specific features and disadvantages of this family: formation of a panel of banks based on indicative quotes, low liquidity of the underlying unsecured interbank market and a lack of confidence on the part of market participants. Nevertheless, MosPrime is the main benchmark of the Russian interest rate derivatives market, and it is used, among others, by foreign counterparties.

One of the goals of the ongoing reform of interest rate benchmarks is to strengthen existing IBOR benchmarks and make them less prone to manipulation. The corresponding changes were implemented in 2017–2019 for LIBOR, EURIBOR and TIBOR in the form of a seamless transition to a waterfall-based determination methodology, which uses transactional data, if available, and allows the use of other input data (*indicative quotes, etc.*) only in the absence of transactional data. In this context, seamlessness means equivalence of the definition and quantitative characteristics of the previous and reformed benchmark.

The relevance of carrying out a similar reform for MosPrime is due to a number of external and internal factors. The key factor is the risks of a reduction in the liquidity of the Russian interest-rate derivatives market after the end of the transition period of European Benchmark Regulation EU BMR, which will prohibit the use of non-authorized third-country benchmarks by European users. Bringing MosPrime in line with BMR requires methodological changes similar to those of the LIBOR, EURIBOR and TIBOR reform. Other factors include the initiatives of the Bank of Russia to bring significant Russian benchmarks in line with international requirements, low trust of end users and the lack of prospects for MosPrime in its current form.

The working group on the MosPrime reform organized by the SRO NFA in 2020 proposed to establish elimination of external risks for MosPrime users associated with taking effect by BMR regulation as the main goal of the reform. In order to solve the task, the methodology and procedures for MosPrime setting process have to be brought in accordance with the BMR requirements, with subsequent authorization of the administrator and/or benchmark by foreign regulators.

The benchmark reform should not create new risks for users, therefore, a seamless type of transition is essential. The requirement of seamlessness limits the depth of possible methodological changes and the degree of improvement in the quality of the benchmark formation, which reduces the long-term potential of the reformed MosPrime.

Nevertheless, the proposed formulation of the problem is not the only possible one. Depending on the target model of Russian benchmarks (*a multiple-rate approach or a risk-free rate centered approach*), the horizon and the mechanism for achieving the specified target model, the optimal scenarios may also include termination of publication of MosPrime or development of a new term credit-sensitive benchmark.

This paper describes alternative problem statements and their corresponding best-case scenarios for determination of the participants' point of view. The results of the consultation will be considered by SRO NFA Expert Council on benchmarks and rates in Q4 2021 to make a decision on further work.

I. INTERNATIONAL REQUIREMENTS FOR THE FORMATION OF BENCHMARKS

- (4) In 2012, central banks and financial regulators of the world's largest economies launched a series of reforms, the overall goal of which is to increase sustainability and quality of the formation of financial benchmarks and to reduce the risks of their use by market participants (*global reform of benchmarks*).
- (5) The starting point of the reform was the revealed facts of manipulation with the rate benchmarks LIBOR, EURIBOR and TIBOR values by banks. Further analysis showed structural imbalance between low volumes of the underlying unsecured interbank market and significant volumes of instruments in relation to benchmarks, which makes the *traditional* system of IBOR benchmarks unstable and prone to manipulation.
- (6) The reform aims to systematically address the problems and shortcomings of the traditional system and includes several related initiatives:
 - IOSCO (International Organization of Securities Commissions) Principles for Financial Benchmarks;
 - Rate benchmark reform of the Financial Stability Board;
 - European Benchmark Regulation (EU BMR).

IOSCO Principles for Financial Benchmarks

- (7) In 2013, International Organization of Securities Commissions (*IOSCO*) developed IOSCO Principles for Financial Benchmarks, which include 19 framework principles for various aspects of the financial benchmark formation.
- (8) The IOSCO Principles received international recognition as a unified standard for the formation of financial benchmarks of the *new* system and formed the basis for other initiatives in the framework of the global reform of benchmarks.

- (9) One of the main principles of the new system is the desire to use data on transactions in the formation of a benchmark (*subject to actual market liquidity*) to reduce the exposure to manipulation risks as compared to the formation based on indicative quotes.

Financial Stability Board: the interest rate benchmark reform

- (10) In June 2013, the Financial Stability Board formed an Official Sector Steering Group of G20 countries financial regulators and central banks to reform the rate benchmarks.
- (11) The document "Reforming Major Interest Rate Benchmarks" published in 2014 provides recommendations on the main directions of the reform:
- Strengthen existing IBOR-benchmarks by underpinning them to the greatest extent possible with transactional data;
 - Developing alternative risk-free benchmarks.
- (12) The FSB endorsed the IOSCO Principles as a single consolidated set of best practices for interest rate benchmark reform.

Reform of IBOR-benchmarks: LIBOR, EURIBOR, TIBOR

- (13) As part of implementation of the first reform provision, the administrators of LIBOR (IBA), EURIBOR (EMMI) and TIBOR (JBATA) proceeded with development and implementation of the necessary methodological changes, which were normally reduced to the following set of actions (*hereinafter IBOR+ means reformed IBOR benchmark*):
- Clearer distinction between the **underlying interest** (*economic variable that the benchmark seeks to measure*) and **methodology** (*how the measurement is made*);
 - Clarification of the definition: instead of defining IBOR as an benchmark based on the interbank deposit market, IBOR+ is defined as an benchmark of the cost of banks' unsecured borrowing in the money market;
- Note: the traditional reference of IBOR to interbank unsecured markets is proposed to be considered as a reflection of the actual bank funding structure until 2008. Since the financial crisis 2008-2009 there has been a significant shift of activity from interbank unsecured markets to a broader range of wholesale financing sources. This approach made it possible to substantiate that the underlying interest of IBOR has not changed, but the methodology should be adapted to better reflect current market conditions.
- In accordance with the clarified definition, the benchmark reflects the borrowing rate;
 - The eligible types of transactions and counterparties was expanded to include a broader range of unsecured funding sources in addition to interbank markets to reflect the actual structure of unsecured bank funding;

- Saving the formation based on the provided values (submissions) of the panel of contributing banks;
Note: hereinafter, the term "quotation" is used in the meaning of "submission". However, if the quote value is formed based on an expert judgment without reference to transactions, then the term "indicative quotation" is used.
 - The transition to a standardized waterfall approach for the formation of quotes by contributors with the setting of the priority of using initial data depending on their availability (note: the practical implementation of the waterfall approach differs between different benchmarks):
 - **Level 1:** The volume-weighted average rate of the submitting bank's eligible borrowing transactions;
 - **Level 2:** in the absence of level 1 data - linear interpolation based on adjacent level 1 values, if available (*for example, for 3M - linear interpolation through 1M and 6M*), using transactions with non-standard maturity (*for example, trades with a maturity of 4 months for 3M*), using transactions from the previous day (*for example, deals for date T-2 at reporting date T-1*);
 - **Level 3:** in the absence of level 2 data - transactions from related markets and expert judgment;
 - Discontinuation of less-used tenors (*2W, 2M etc.*).
- (14) In 2017–2019, the administrators of LIBOR, EURIBOR and TIBOR implemented a waterfall-based methodologies, while the regular publication of the input data structure by the administrators indicates the continued active use of Level 3 data (*expert judgment*) due to the lack of transactions.
- (15) A similar reform has been carried out or is being considered for other IBOR benchmarks: WIBOR (Poland), STIBOR (Sweden), NIBOR (Norway), HIBOR (Hong Kong), etc.

European Benchmark Regulation EU BMR

- (16) European Benchmark Regulation (EU Benchmark Regulation, BMR) is synchronized with the IOSCO Principles and establishes requirements for the processes of benchmark formation (administration), provision of data for the benchmark formation and benchmark use in financial instruments by European users;
- (17) A characteristic feature of BMR is presence of a closed list (register) of administrators and third-country benchmarks (ESMA Register) allowed for use in financial instruments by supervised users in Europe.
- (18) BMR took effect on January 01, 2018, with the transitional provisions for third-country (including Russian) administrators and benchmarks. After the end of the transition period, supervised users in Europe will be prohibited from using non-authorized third-country benchmarks.

- (19) In the UK, after Brexit, there is a retained version of benchmark regulation (UK BMR) with its own register of administrators and third-country benchmarks (UK Benchmarks Register) and different end dates for the transition period: in Europe (EU BMR) - December 31, 2023, in the UK (UK BMR) - December 31, 2025 (note: given the longer transition period for UK BMR, further discussion takes place in the context of the European Regulation EU BMR or simply BMR)
- (20) Interest rate benchmarks are subject to the special requirements of BMR, including the general priority (waterfall) of use of input data.

II. KEY FACTORS OF THE MOSPRIME REFORM

- (21) The relevance of the issue concerning the MosPrime reform is due to a number of external and internal factors described in the previous section and below:
- A. Risks of taking effect by EU BMR provisions for non-European benchmarks;
 - B. Initiatives of the Bank of Russia to improve the quality of the Russian benchmarks formation;
 - C. Structural vulnerability of MosPrime as an IBOR benchmark:
 - D. The ongoing reform of foreign IBOR benchmarks;
 - E. Lack of trust on the part of users;
 - F. Development of alternative Russian benchmarks.

Risks of taking full force by European regulation EU BMR

- (22) Taking effect by the provisions of the European regulation EU BMR for non-European benchmarks will mean that European users will be restricted from using MosPrime in new transactions, which will result in a decrease in the liquidity of the Russian interest-rate derivatives market as a whole.
- (23) For the purpose of accreditation under EU BMR, the MosPrime formation methodology and procedures must be brought in line with the BMR requirements, which are largely synchronized with the IOSCO Principles.

Initiatives of the Bank of Russia to improve the quality of formation of Russian benchmarks

- (24) Representatives of Russian financial regulators take part in the work of the Financial Stability Board, the International Organization of Securities Commissions (IOSCO) and other international organizations and associations, and support initiatives to reform interest rates.

- (25) Russian legislation does not establish requirements for activities related to the formation of financial benchmarks, data provision for the formation of benchmarks and/or use of the benchmarks in instruments (*by analogy with BMR*). Nevertheless, the Bank of Russia has developed interaction with Russian administrators in order to bring significant Russian benchmarks (*including MosPrime*) in line with international requirements.
- (26) The Bank of Russia also offers Russian administrators a voluntary procedure for confirmation (*accreditation*) by the regulator of the quality of the benchmark formation. In 2017, MosPrime received accreditation from the Bank of Russia, however, there are risks that the regulator will review the decision in the absence of independent confirmation of MosPrime's compliance with international requirements (*which implies an independent audit of compliance with the IOSCO Principles and/or accreditation within the BMR*).

Structural vulnerability of MosPrime as an IBOR benchmark

Low liquidity of the interbank market

- (27) The global financial crisis of 2008–2009 resulted in a significant reduction in the volume of unsecured borrowing by banks in the interbank market as a result of banks' reassessment of counterparty risks and introduction of new regulatory requirements (*Basel 3*).
- (28) In accordance with Principle 7 of IOSCO (*Data Sufficiency*), formation of the benchmark should be based on an active, observable market, which, depending on the actual activity in the derivatives segment of the Russian interbank market, may require expansion of data sources for the formation of MosPrime.

Indicative nature of submitted quotes

- (29) MosPrime setting process is based on the submissions (indicative quotations) of the panel banks (*submitters*). Under the conditions of low liquidity of the interbank market, the submissions are not anchored in transactions, while each submitter uses its own methodology for calculating submissions.
- (30) Committed quotes have a higher status in the hierarchy of input data compared to the indicative quotes in accordance with IOSCO Principle 8 (*Hierarchy of Data Inputs*). Submitted quotes of Mosprime submitters have a *quasi-committed* status, where each submitter has the right to conclude deposit transactions at the quote of another submitter within 30 minutes from the publication time.
- (31) Effectiveness of the verification transactions appears to be limited for a number of reasons:
- The obligation is conditional - the submitter is released from the obligation to conclude transactions in the absence of a free/established limit for the submitter who sent the request;
 - Borrowing transactions of submitters with VEB.RF need adjustments as compared to the submitted quotes due to the special status of VEB.RF and reserve requirements;

- The current sanctions regime limits the ability of submitters with foreign participation to enter deposit transactions with some Russian banks

Panel shrinkage risks

- (32) Currently, the MosPrime panel includes 8 Russian banks, while the possibilities of expanding or maintaining the composition of the panel when one or several submitters leave are limited:
- Expansion of the panel at the expense of Russian banks *with foreign participation* is limited due to the desire of parent organizations to minimize the legal, regulatory and reputational risks of participation in the formation of IBOR benchmarks as a submitter;
 - Expansion of the panel at the expense of Russian banks *without foreign participation* is limited by the requirement of homogeneity of the bank credit quality.
- (33) The panel shrinkage with limited replacement options may compromise representativeness of the benchmark and increase its susceptibility to manipulation.

Lack of confidence on the part of users

- (34) The factor of trust of end users (customers) to the benchmark determines the potential of its use in products and instruments. MosPrime in its current form is not trusted by customers for a number of reasons:

Common factors for IBOR benchmarks:

- Distrust in IBOR-benchmarks based on indicative quotes potentially subject to manipulation;
- Formation by central banks and financial regulators of an drive to abandon IBOR benchmarks in favor of alternative risk-free benchmarks;
- Subjective perception of IBOR benchmarks as a receding element of the traditional system;

Specific factors for MosPrime:

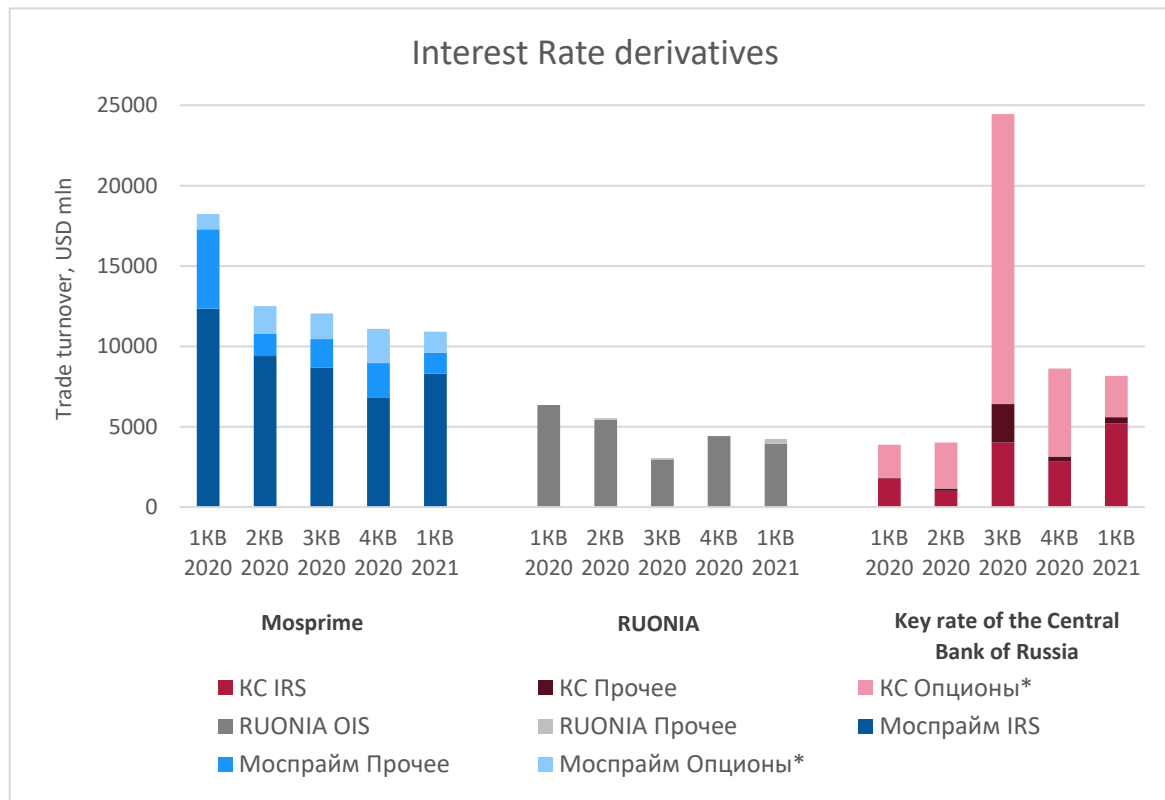
- Distrust of Russian non-bank participants to interbank benchmarks with a formation that is not transparent for such participants;
- Lack of confidence in the representativeness of the benchmark due to a sharp increase in MosPrime values during the crisis periods of 2008 and 2014.

Questions to Section «II. BACKGROUND FOR THE MOSPRIME REFORM»:

- Evaluate the above factors A-F in terms of their significance for making a decision to reform MosPrime. Use a scale of 1 (*not significant*) to 5 (*most significant*) to rate each factor.

III. ALTERNATIVE INTEREST RATE BENCHMARKS

(35) MosPrime is used as a benchmark in the ruble-denominated derivatives market, while the use of MosPrime in loans and bonds is insignificant.

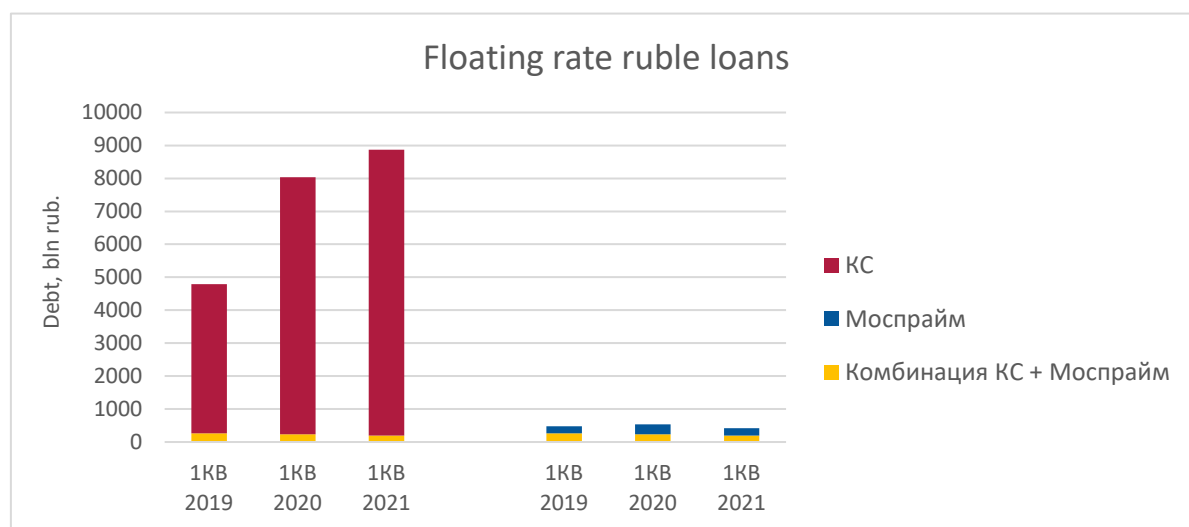


1KB 2KB 3KB 4KB	Q1 Q2 Q3 Q4
Мосспрайм прочее	MosPrime other
KC Прочее	Key Rate other
RUONIA Прочее	RUONIA other
Мосспрайм Опционы*	MosPrime Options*
KC Опционы*	Key Rate Options*
Мосспрайм IRS	MosPrime IRS

Fig. 1. Structure of the turnover of the Russian interest rate derivatives market in 2020–2021 (in USD mln). MosPrime, RUONIA and the key rate of the Central Bank of the Russian Federation have relatively developed markets for derivatives, the most liquid instrument is the IRS on MosPrime, the key rate of the Central Bank of the Russian Federation is actively used in nonlinear hedging instruments (*options cap, floor and their combinations*).

**Note: a combination of options (for example, cap + floor), depending on the order of recording in the books, can be accounted for as several transactions with a multiple increase in the total turnover.*

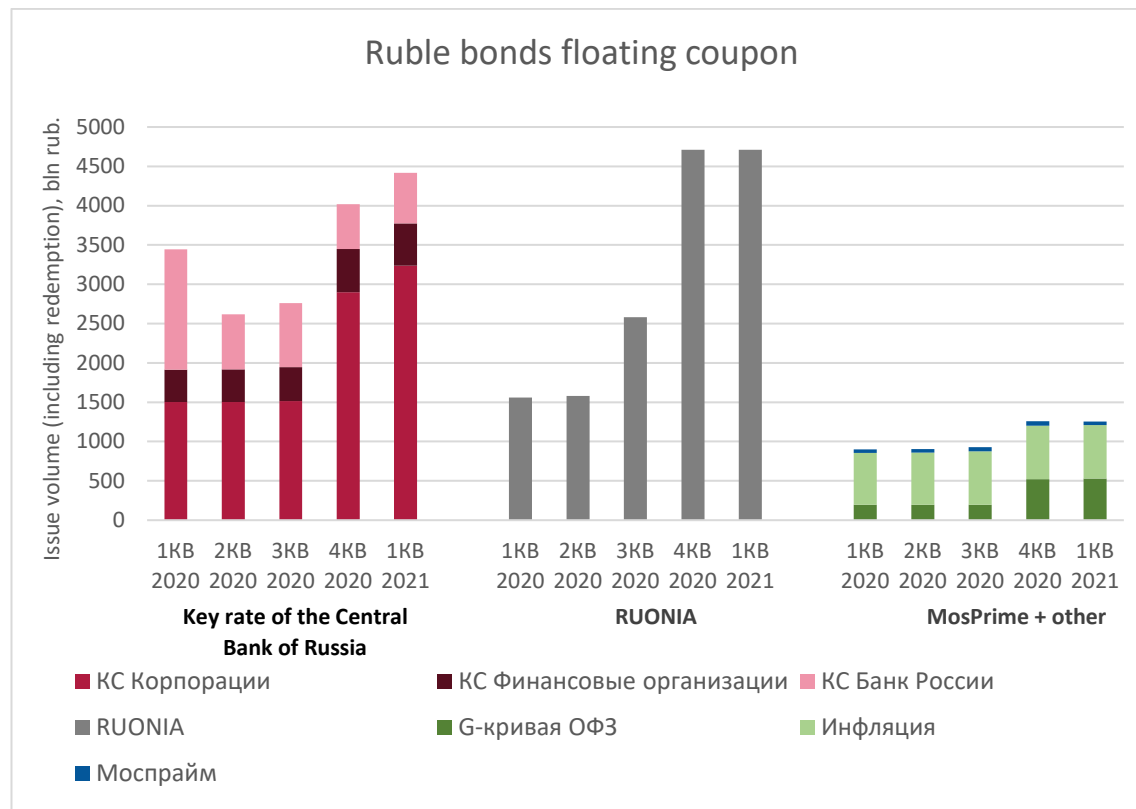
Source: Bank of Russia report "The structure of the turnover of the domestic foreign exchange market and the market for financial derivatives (according to the BIS methodology)".



1KB	Q1
KC	Key Rate
Моспрайм	MosPrime
Комбинация KC + Моспрайм	Combination Key Rate + MosPrime

Fig. 2. Structure and amount of ruble denominated floating-rate loans in 2019–2021 (*billion rubles*). The key rate is widely used in floating-rate loans, MosPrime is used far less often, in particular, as a part of combination with the key rate.

Source: Bank of Russia report "Information on the structure of debt on loans and acquired rights of claim on loans granted to resident legal entities and individual entrepreneurs, in the context of the type of interest rate and base component"



1KB 2KB 3KB 4KB			Q1 Q2 Q3 Q4		
КС Корпорации	KR Corporation	КС Финансовые организации	KR Financial organizations	КС Банк России	KR Bank of Russia
Моспрайм	MosPrime	G-кривая ОФЗ	Federal Loan Bond G-curve	Инфляция	Inflation

Fig. 3. Volumes of floating rate notes issued including redemption (in billion rubles). RUONIA is used in the floaters of the Ministry of Finance of Russia (FLB-floating coupon), the key rate of the Bank of Russia is used by a number of issuers, with the bulk being the share of PJSC NK Rosneft (~ 2.4 trillion rubles at the end of 1Q 2021).

Source: Bank of Russia report “Variable coupon debt securities issued in the domestic market by type of base benchmark”.

(36) Currently, several alternative benchmarks are available on the Russian market for use instead of MosPrime.

RUONIA and RUONIA term versions

- (37) RUONIA is administered by the Bank of Russia (*until May 2020 – by SRO NFA*) and calculated based on unsecured interbank deposit overnight transactions of the panel of banks.
- (38) In the derivatives market, RUONIA is used in Overnight Index Swaps (OIS), while the liquidity of the OIS market on RUONIA is mainly concentrated in a short period (up to 1 year).
- (39) Other examples of using RUONIA as a reference benchmark are:
- Floating rate notes (*floaters*) of the Russian Ministry of Finance (*FLB-floating coupon*);
 - Placement by the Federal Treasury of federal budget funds in bank deposits at a floating rate.
- (40) When using RUONIA, the floating rate of the interest period in instruments is determined based on the realized RUONIA values for the specified period, averaged by the formula of simple (*FLB-floating coupon*) or compound (*OIS*) interest and determining the value at the end of the period (*in-arrears convention*).
- (41) For instruments on IBOR benchmarks (*IRS on MosPrime 3M*), the floating interest rate is determined at the beginning of the period, which can be achieved using RUONIA in one of the following ways:
- Based on realized RUONIA values for the previous interest period (*in-advance convention*), example – old format FLB-floating coupon (*before August 2019*);
 - Based on expected values of RUONIA for the future period, determined based on the derivatives market on RUONIA.
- (42) The second approach can be implemented using the ROISfix benchmark, which is administered by the SRO NFA based on OIS quotes on the RUONIA panels of banks for up to 6 months and can be used similarly to MosPrime (*IRS on ROISfix 3M*).
- (43) In international practice, these approaches (*based on the realized values in both conventions - in-advance and in-arrears, and on predicted values*) for risk-free benchmarks are considered as complementary, while the efforts of regulators and central banks are aimed at developing the approach based on realized values as more reliable and sustainable, while *term risk-free rates* are considered for limited niche use.
- (44) The Bank of Russia is considering the possibility of publishing "synthetic" RUONIA - term versions of RUONIA based on realized RUONIA values for the past period, by analogy with the practice of other central banks - administrators of the corresponding risk-free benchmarks (*SOFR - Federal Reserve Bank of New York, ESTR - European Central bank, SONIA - Bank of England, etc.*)

RUSFAR

- (45) RUSFAR benchmark is administered by the Moscow Exchange and calculated based on General Collateral Certificate (GCC Bonds) CCP-cleared REPO transactions and executable quotes of broad array of market participants.
- (46) Unlike other alternative benchmarks, RUSFAR is calculated based on both overnight (RUSFAR O/N) and term REPO (RUSFAR 3M), which allows RUSFAR to be used in various conventions:
 - RUSFAR O/N – in a backward-looking form based on realized values, similar to RUONIA in OIS;
 - RUSFAR 3M – as a forward-looking term rate similar to MosPrime in IRS.
- (47) At the time of publication of this report, RUSFAR is not widely used in the Russian market as a reference benchmark.

The key rate of the Bank of Russia

- (48) The key rate of the Bank of Russia (KR) is established by the Board of Directors of the Bank of Russia and is one of the instruments of monetary policy.
- (49) The key rate of the Bank of Russia is not a market indicator formed on the basis of supply and demand of independent market participants; however, it has become widespread in the Russian market as a reference benchmark in loans and in nonlinear loan hedging derivatives instruments (*options cap, floor, etc. their combinations*).
- (50) Key Rate does not have a term structure and, similarly to risk-free overnight benchmarks, is used in transactions in the realized backward-looking form based on simple or compound interest (*note: the forecast values of the key rate published by the Bank of Russia are not intended for use in financial instruments as a benchmark*).

Questions to Section III. ALTERNATIVE BENCHMARKS FOR MOSPRIME:

1. Which of the alternative benchmarks has, in your opinion, the greatest potential for development in the derivatives market?
2. Do you think an alternative benchmark should be the same for derivatives, loans and bonds?
3. What characteristics should a derivatives market benchmark have to enjoy long-term prospects of use? Are any of MosPrime's defining features relevant to the derivatives market?
4. How long, in your opinion, may it take to adapt alternative benchmarks in the derivatives market with a significant reduction in the use of MosPrime?
5. Do you think that MosPrime, if successful, has long-term prospects? Can you give examples of tasks for which MosPrime can be indispensable (for example, as the only ruble-denominated credit-sensitive term benchmark)?

IV. DESCRIPTION OF THE MOSPRIME REFORM SCENARIOS

- (51) In August 2020, the SRO NFA formed an expert working group on the MosPrime reform, which described several scenarios for further actions by the administrator to select the optimal scenario at the next stage in accordance with the goals set.

Scenario 1: No action

- (52) In this scenario, the administrator does not take any action to bring the MosPrime administration methodology and model in line with international requirements. Publication of the benchmark in the current methodology continues for an indefinite period of time.
- (53) **In the short term**, MosPrime will maintain its position as a benchmark of the derivatives market with a gradual shift of activity to alternative benchmarks (Key Rate, RUONIA and RUSFAR).
- (54) **In the medium term**, realization of the following risks for users is possible:

- After the end of the EU BMR third-country transition period European counterparties will not be allowed to use MosPrime and will withdraw from the MosPrime derivatives market, while Russian and some foreign counterparties (*from the UK and outside BMR jurisdictions*) will maintain their presence;
- Reduced market liquidity may lead to higher costs when trading and managing open positions on MosPrime;
- Slower-than-expected adaptation of alternative risk-free benchmarks (Key Rate, RUONIA and RUSFAR) by European counterparties after their withdrawal from the MosPrime derivatives market will reduce the liquidity of the Russian interest rate derivatives market as a whole;

(55) **In the long term**, the remaining participants will shift to using alternative benchmarks in instruments instead of MosPrime while retaining the benchmark as an analytical indicator for analyzing the situation in the money markets (*by analogy with RuREPO and NFEA FX Swap Rate*)

International practice:

(56) Administrators of some local IBOR benchmarks do not take actions to bring benchmarks in compliance with BMR requirements due to the high costs of the procedure and concurrent lack of licensing income.

Note: In its 2019 BMR consultation, the European Commission indicated that there is no incentive for non-European administrators to align their indicators with BMR requirements: “In the absence of licensing income from EU users, many third-country benchmark administrators might not have the incentive to seek either recognition or endorsement of their benchmarks for use in the Union [...]”

Questions to Section “Scenario 1: Inaction”:

1. Do you agree with the description of the outcome and risks of this scenario? Can the scenario be considered as the main one?
2. Do you think that the risks of restricting European users' access to instruments on MosPrime are significant?

Scenario 2: Discontinuation of MosPrime

- (57) In this scenario, MosPrime continues to be published in the current determination methodology up to the cessation date announced in advance by the administrator.
- (58) The administrator can be guided by the following factors when choosing the date of discontinuation of publication:
- End date of the BMR third-country transition period in Europe and/or the UK (*in Europe - December 31, 2023, in the UK - December 31, 2025*);
 - Expiration of legacy trades on MosPrime (*for the planned reduction of the main part of the concluded trades, subject to the limitation of new deals*);
 - Expected or target dates for adaptation of alternative benchmarks in the derivatives market (RUONIA, RUSFAR, Key Rate).

- (59) **In the short term**, announcement of the upcoming discontinuation of MosPrime publication will lead to an increase in the pace of adaptation of risk-free benchmarks (KR and RUONIA, first of all) with the continued use of MosPrime "by inertia"
- (60) **In the medium term**, realization of the following risks for users is possible:
- Early withdrawal of foreign counterparties from the market will result in a significant reduction in liquidity and an increase in costs when trading and managing open positions on MosPrime even before the actual termination of publication;
 - The withdrawal of foreign (*European*) counterparties may also be associated with taking full effect by the BMR regulation if the end date of the BMR third-country transition period comes before the established date of termination of publication;
 - Slower-than-expected adaptation of alternative risk-free benchmarks by foreign counterparties after their withdrawal from the MosPrime derivatives market will reduce the liquidity of the Russian interest rate derivatives market as a whole;
 - For legacy trades on MosPrime, the risks may be associated with the lack of fallback provisions that would work in a situation of discontinuation of MosPrime, and the need to revise terms of concluded transactions with a replacement for an alternative benchmark.
- (61) **In the long term**, discontinuation of MosPrime will reduce fragmentation in the Russian market, while emergence of new term credit-sensitive benchmarks is possible.

International practice:

- (62) IBA administrator reformed LIBOR benchmark (Great Britain) with the implementation of a seamless transition, however, the fundamental impossibility to significantly improve the quality of the benchmark formation given the scale of its use in products, it led to the decision to discontinue publication.

Questions to Section “Scenario 2: Discontinuation of MosPrime”:

1. Do you agree with the description of the outcome and risks of this scenario? Can the scenario be considered as the main one?
2. What do you think should be an acceptable deadline for publication in this scenario?
3. In your opinion, should the transition to alternative benchmarks in this scenario be accompanied by choosing the main alternative benchmark (*by analogy with the LIBOR reform*)?

Scenario 3: Seamless reform

- (63) In this scenario, the administrator implements a set of measures to bring the formation of MosPrime in accordance with international requirements, including:

Methodology changes:

Note: for more details on the methodology changes, see Section "Reform of IBOR benchmarks: LIBOR, EURIBOR, TIBOR"

- Clarification of the MosPrime underlying interest and definition;
- Clarification or expansion of the market based on MosPrime's formation to fulfill the data sufficiency principle (*formation of a benchmark based on an active, observed market*);
- Clarification of the composition of submitters and the procedure for changing it;
- Implementation of a standardized waterfall methodology of calculating submissions using transactional data, if any;
- Development of a backup procedure for MosPrime formation;
- Termination of publication of less used tenors.

Administration model:

- Bringing the processes of monitoring, control and management of the administrator's conflict of interests in line with international requirements;
- Introduction of a *Code of conduct* describing the rights and obligations of submitters and the procedure for quotes formation;
- Going through the external audit procedure for compliance with IOSCO principles;
- Going through the accreditation procedure in accordance with the BMR provisions.

- (64) A prerequisite for this scenario is to ensure seamlessness (*see below*) to minimize risks for existing transactions.

Seamless transition

- (65) The concept of seamless transition was introduced in a special report by Market Participants Group to the Financial Stability Board in 2014, which identified seamless transition as a preferred option for reforming IBOR benchmarks by minimizing risks to existing users as compared to other forms of transition.

- (66) The report does not provide clear criteria for seamlessness, however, some of them can be distinguished from the practice of IBOR benchmarks reform:
- Saving the benchmark name;
 - Saving the place of publication (*website, vendor pages*);
 - Retaining the benchmark definition (*note: see the Reform of IBOR Benchmarks section for the rationale why inclusion of additional market segments in the calculation was not considered as a change in the benchmark definition*);
 - Retaining of the benchmark quantitative characteristics (*value, volatility*) within the limits of permissible deviations.
- (67) Saving the benchmark name and place of publication eliminates the need to amend the terms of transactions, while maintaining the definition and characteristics of the benchmark reduces financial and legal risks.
- (68) Seamless reform will not result in a significant improvement in the quality of MosPrime formation due to the limitations imposed by the seamlessness criteria on the depth of methodological changes.
- (69) **In the medium term**, successful reform and accreditation of MosPrime within the BMR will ensure continued presence of foreign counterparties on the market and increase attractiveness of the benchmark for users, while the trend of switching to risk-free benchmarks will be maintained and the volumes of transactions on MosPrime will further decline in relative terms.
- (70) The costs incurred at the stage of preparation for the accreditation procedure are supposed to be financed from voluntary contributions and/or own funds of SRO NFA, subsequent costs - from licensing proceeds after implementation of the commercial model of the reformed MosPrime distribution.
- (71) Risks to users are associated with late execution of seamless reform for one or more reasons:
- The impossibility to meet the seamless criteria without significantly weakening the criteria or reducing the requirements for the result, which can lead back to uncertainty and a replacement of the scenario;
 - Violation of the accreditation terms within the BMR due to the high labor intensity of this process in the current regulatory regime, the lack of established accreditation practice for non-European benchmarks, etc.;
 - Slowing down the reform execution process for other reasons (*the need to attract additional funding, etc.*);
 - Reduction of the MosPrime panel as a result of banks revising readiness of their participation due to the increased responsibility and burden on submitters and the need to search for a possible replacement.

- (72) **In the long term**, a decrease in the market liquidity for instruments on MosPrime will stimulate the transition to risk-free benchmarks and an even greater reduction in liquidity (*a process with positive feedback*) up to actual termination of MosPrime use as a benchmark in the derivatives market.
- (73) In this case, publication of the benchmark can continue for an indefinite period of time, subject to flow of licensing proceeds and/or voluntary contributions to maintain accredited status within the BMR.

International practice:

- (74) EURIBOR (Eurozone) TIBOR (Japan) indicators were successfully reformed using the seamless transition to waterfall methods of formation in the absence of plans to stop the benchmark publication.

Questions to Section “Scenario 3: Seamless reform”:

1. Do you agree with the description of the advantages and disadvantages of a seamless transition scenario? Do you consider this scenario as the main option?
2. Do you think it is possible to define MosPrime as a benchmark of the unsecured bank borrowing costs and to transfer the issue concerning a choice of specific market segments into the methodology (in order to justify preservation of the benchmark definition)?
3. Do you think it is potentially possible to include in the calculation data on transactions from other segments of the money market, provided that quantitative criteria of seamlessness are met? Please, specify data sources that can potentially be included in the calculation:
 - Submitter unsecured borrowing transactions with other credit institutions (*outside the panel*);
 - Submitter unsecured borrowing transactions with non-bank financial institutions;
 - Submitter unsecured borrowing transactions with non-financial organizations (*corporations*);
 - Transactions from other market segments: REPO, OIS, currency swaps.
4. When switching to a waterfall formation method, do you think it is expedient to adjust the rates on transactions by spread in order to maintain the particular MosPrime level, subject to its current calculation based on supply quotes? How would you suggest calculating the adjustment amount?
5. Is it reasonably practicable for your organization to switch to a commercial model of MosPrime distribution after its reform? Could this affect the nature of its use?

Scenario 4: New benchmark

- (75) The main difference between this scenario and scenario 3 is absence of requirements for seamlessness, which creates an opportunity for deeper methodological changes in MosPrime and/or the development of a fundamentally new benchmark.
- (76) Compliance with seamless requirements can be difficult for a number of reasons:
- To comply with the requirements for the benchmark formation based on an active market, it may be necessary to expand/change the basic market segments (*for example, inclusion of deposit transactions with non-bank counterparties*) with different pricing compared to the interbank market;
 - Transaction-based benchmarks are generally more volatile than those based on indicative quotes;
 - The transition to the benchmark formation from the borrowing side will result in a change (*decrease*) in the rate level as compared to MosPrime without a corresponding adjustment;
 - Transaction-based formation may require an increase in the data collection window (*up to the use of data on transactions for the whole day*) as compared to MosPrime fixing at a certain point of time within the day.
- (77) One of the possible options for action in this case is to start publication of a new benchmark and continue to publish MosPrime in the current methodology or cease its publication.
- (78) Thus, the following possible lines can be distinguished within the general scenario:
- Scenario 4.1: Non-seamless MosPrime reform;
 - Scenario 4.2: New benchmark + inaction for MosPrime;
 - Scenario 4.3: New benchmark + discontinued publication for MosPrime.

Scenario 4.1:

- (79) **In the medium term**, non-seamless reform of MosPrime creates risks of losses for the parties to open transactions and risks of termination of the transaction due to material changes in the benchmark.
- (80) To mitigate these risks, it will be necessary to revise the terms of open transactions and/or introduce compensation payments, which may be associated with a large amount of negotiation work.

- (81) Non-seamless reform of MosPrime also creates behavioral risks (*when the negotiating position of one of the parties dominates*) and risks of opportunistic behavior (*selective actions under separate contracts depending on whether the party gains or losses as a result of the reform*).
- (82) With regard to the described risks, it is possible for participants to actively switch to alternative risk-free benchmarks for existing transactions on MosPrime by revising the terms of transactions or early closing of the existing transactions and concluding new ones.
- (83) **In the long term**, non-seamless reform of MosPrime will be accompanied by a more significant improvement in the quality of formation compared to the seamless reform, thus offering a potential to retain MosPrime as a niche benchmark for use in specific tasks.

Scenarios 4.2 and 4.3:

- (84) **In the medium term**, creation of a new benchmark while maintaining publication of MosPrime will increase the fragmentation of liquidity between different market segments, for existing MosPrime users the risks will be similar to those described for scenarios 1 and 2.
- (85) **In the long term**, the new benchmark can possibly be retained as a niche benchmark for use in specific tasks.

International practice:

- (86) In international practice, IBOR indicator administrators avoid the non-seamless reform scenario (*scenario 4.1*):
- The initial project of EURIBOR restructuring (*from 2015 to 2017*) assumed the transition to the formation entirely based on transaction data (*transaction-based EURIBOR*). Following the results of the methodology prototype tests, the administrator (EMMI) concluded that a seamless transition was impossible, therefore, the project was closed. As part of the subsequent work (*in 2018–2019*), EMMI successfully executed a seamless transition to an alternative *hybrid methodology* for EURIBOR formation (*scenario 3*).
 - Within SIBOR indicator reform (Singapore), the waterfall approach ensured a significant reduction in dependence on expert judgment (*due to the inclusion of deposit transactions with corporations in the calculation*), however, the characteristics of the resulting prototype (*particular level and volatility*) differed from the initial ones. Following the test results, the administrator (ABS) decided to abandon the non-seamless reform in favor of the phased termination of SIBOR publication (*scenario 2*).
 - Along with preparations for the termination of LIBOR publication, LIBOR Administrator (IBA), is developing a new term unsecured benchmark with a credit component - ICE Bank Yield Index (*scenario 4.3*).

Questions to Section “Scenario 4: New indicator”:

1. Do you think it is possible and advisable to develop a new term unsecured benchmark with a credit component? For what purposes and tasks can it be in demand? *(see also questions in the Alternative Benchmarks section)*
2. Which of the scenarios do you consider as the most acceptable:
 - Non-seamless transition for MosPrime
 - New indicator + no action for MosPrime
 - New indicator + discontinued publication for MosPrime
3. What measures, in your opinion, can be taken to mitigate risks in a non-seamless transition scenario for MosPrime?
4. On the basis of which segments of the money market would you propose to form a new benchmark?

V. SETTING THE REFORM TASKS AND CHOOSING THE OPTIMAL SCENARIO

- (87) As part of the discussions, 3 options for setting the reform task were formulated, which differ in their main goals:
- **Task A statement:** elimination of external risks for MosPrime users while maintaining an evolutionary, natural transition towards the target model based on risk-free benchmark;
 - **Task B statement:** active transition towards the target model based on risk-free benchmarks;
 - **Task C statement:** preservation of MosPrime in the long term in the target model of the variety of benchmarks.
- (88) The task statement determines a number of applicable criteria for choosing the optimal scenario, the general list of criteria is given in Table 1.

	Scenario 1. No action	Scenario 2. Discontinuation of MosPrime	Scenario 3. Seamless reform	Scenario 4. New benchmark
1. Minimization of risks for the existing users	Low	Medium	High	Medium
2. Predictability of the final result	Low	High	Medium	Medium
3. Compliance with IOSCO-FSB-BMR requirements	Low	Low	High	High
4. Improvement of quality and representativeness	Low	Low	Medium	High
5. Saving resources and labor costs	High	Medium	Low	Low
6. Preserving the diversity of benchmarks	Medium	Low	High	High
7. Encouraging the transition to risk-free benchmarks	Medium	High	Medium/ Low	Medium

Table 1. General list of criteria for choosing the optimal scenario.

Task A statement: elimination of external risks for MosPrime users

- (89) In the context of this statement, the MosPrime reform is an auxiliary, but necessary stage to ensure the continuity of the markets functioning as the participants gradually adapt alternative risk-free benchmarks.

- (90) The aim of the work is to eliminate the risks of banning the use of MosPrime by European counterparties after the end of the BMR transitional period. As a means of achieving the main goal, the reform should not create new risks for users (*seamless reform*), while the issue of improving the benchmark quality and representativeness is not a priority.

Applicable criteria:

- *Minimization of risks for the existing users;*
- *Predictability of the final result;*
- *Preserving the diversity of benchmarks;*
- *Compliance with IOSCO-FSB-BMR requirements.*

Optimal scenario: “Scenario 3. Seamless reform”

Task B statement: active transition towards the target model based on risk-free benchmarks

- (91) This statement emphasizes the need for an active transition to risk-free benchmarks and the elimination of fragmentation in the market. The MosPrime reform will slow down the transition processes and will not be worth the effort.
- (92) Efficiency (*in terms of labor*), predictability and controllability of the transition process are essential criteria, while efforts should be directed to the timely adaptation of risk-free benchmarks and mitigation of the transition risks for existing users (*similar to the LIBOR reform*).

Applicable criteria:

- *Minimization of risks for the existing users;*
- *Predictability of the final result;*
- *Encouraging the transition to risk-free benchmarks;*
- *Saving resources and labor costs.*

Optimal scenario: “Scenario 2. Discontinuation of MosPrime”

Task C statement: preserving MosPrime in the long term

- (93) In accordance with this statement, the MosPrime reform should not be considered as an auxiliary stage in the transition to risk-free benchmarks, but is an independent task with the ultimate goal to launch on the Russian market a representative term unsecured benchmark that meets international standards.

- (94) The prospect of further development of the instrument market justifies the deeper nature of the MosPrime changes with an emphasis on the quality of the result achieved, including the non-seamless nature of the changes and/or the creation of a new benchmark.

Applicable criteria:

- *Minimization of risks for the existing users;*
- *Preserving the diversity of benchmarks;*
- *Compliance with IOSCO-FSB-BMR requirements;*
- *Improvement of quality and representativeness.*

Optimal scenario: “Scenario 4. New benchmark”

Proposals of the SRO NFA Working Group on the MosPrime Reform

- (95) With regard to the points of view expressed, SRO NFA Working Group on the MosPrime Reform proposed to establish elimination of external risks for MosPrime users, while maintaining an evolutionary approach to the benchmark system development (*task A statement*), as the main task of the reform, which corresponds to the optimal scenario 3 (*seamless reform*)

Questions to Section “V. CHOOSING A SCENARIO FOR MOSPRIME REFORM”:

1. Do you consider the choice of the working group the best option out of the proposed ones? Give reasons for the option you have chosen if it differs from the choice of the working group.
2. Can you specify alternative task statements and/or criteria for choosing the best scenario?