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Russian Financial Market Development Strategic Initiatives Under Sanctions and in the Aftertime

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ABSTRACT

New challenges and restrictions, imposed by a number of countries, affected the Russian financial system and real sector of economy, so implementation of responsive strategic decisions to support financial and real sectors of the economy is necessary. The study's goal is to develop proposals for financial market strategy in new conditions, to support investment opportunities for Russian investors and investors from friendly and neutral countries, to control capital flow in the medium term. The research result is the justification of the new model of the Russian financial system, which is based not only on liberal economic paradigm but also on realities of economic pressure on our country. In the current crisis, it is advisable to have two models of the financial market: the first is based on recognized international principles, which applied to large public Russian companies; the second is focused on companies under sanctions and regional business. Strengthening regulation of cross-border capital movement, including introduction of strict restrictions on capital withdrawal, as well as limits on operations on foreign exchange market, are seen not only as temporary anti-crisis instruments of state regulation, but as the basis for strategy construction for the financial market development. Support of the state development institutions, commercial banks and large corporations of the limited interaction model with developed countries will reduce systemic risks not just in critical periods, but also in the future. Therefore, this can attract resources to real investment projects and stimulate the growth of the capitalization of Russian companies.

Keywords: strategy; financial market; sanctions; capital flow; international financial institutions

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INTRODUCTION

The main objective of the Financial Market Development Strategy of the Russian Federation[1] until 2020 has been to build institutional environment and regulation that increased the attractiveness of the financial market for foreign investors and helped overcome the significant dominance of banks over non-bank financial institutions. This development model was appropriate at a certain historical stage, and was aimed mostly at inflow of foreign investments into the financial market [1]. However, at the same time capital outflow intensified, which was caused by acquiring by Russian residents various assets abroad, including foreign securities, real estate, and allocation of significant part of savings (of the state, corporations, citizens) in foreign currencies and money market instruments of the developed countries.

However, despite the fact that financial market institutions in our country were largely in line with current international requirements, the COVID-19 pandemic required new approaches to economic development. The main challenges of the pandemic led to increased regionalisation processes in the real economy, while central banks' pumping of liquidity into their economies with minimal capital controls led to a fairly rapid recovery of financial markets and rapid growth in capitalisation of post-

[1] URL: https://www.garant.ru/products/ipo/prime/doc/12064654/

industrial companies in developed economies (pharmaceuticals, information technology, digital platforms, etc.).

In effect, the pandemic was the starting point of another historical phase of accelerated concentration of financial resources in developed countries. While significant consumptions concentrated in developed countries, at the same time, much of the material and labor resources as well as manufacturing were being located elsewhere, and logistics and access were becoming more complex.

It can therefore be assumed that the gap between the financial and real sectors of the economy was widening, and that regional imbalances were growing, which required new approaches for improving the efficiency of the reallocation of savings into real investments.

The IMF report noted that funds were channeled into financial markets due to the cheap money policies of the developed world. But these inflows were not so much transformed into investments, but lead to increase in savings, real estate, assets in the global financial market, as well as consumer and food price inflation.[2] Sanctions related to the special military operations in Ukraine have also required from developed countries to take additional measures to support their economies. As a result, the value of certain assets (shares of some companies in the technology, pharmaceutical and military industries) increased. Such growth was not based on fundamental reasons. The economic policy in the US increased the volatility of the financial market, which of course did not contribute to the stability of the world financial system.

Moreover, rising interest rates in developed countries with high levels of debt threaten the global financial system. The ability to issue additional debt is limited. This makes it necessary for a number of countries to look for alternative sources of financing, including the use of foreign resources. This increases the risks for Russian (as well as other many foreign) investors to place their reserves and savings in traditional reserve currencies of developed countries. Based on US Treasury Directive 4 of 28 February 2022, some Russian assets in the US have been frozen through a ban on any transactions with the Bank of Russia, the Russian National Welfare Fund, the Russian Ministry of Finance, and others.[3] The restrictions, which were extended in stages in 2022, were also imposed by the European Commission.[4]

In this context, an important task for our country is to find alternative assets to place state reserves. Such assets could be precious metals, alternative currencies, etc.

It seems that with the onset of the pandemic, or even somewhat earlier, the Russian stock market development strategy aimed exclusively at creating a modern infrastructure and transparent rules for foreign investors in economy of free capital flow has lost relevance, as new global trends have emerged [2]. At this stage, it would be advisable not so much to adjust the strategy of financial market development to adapt it to the periods of crisis, as to fundamentally revise this strategy [1].

An alternative model should, on the one hand, stimulate the inflow of investors'

[2] Fault Lines Widen in the Global Recovery. World Economic Outlook Update. URL: https://www.imf.org/en/Publications/WEO/Issues/2021/07/27/world-economic-outlook-update-july-2021 (accessed on: 03.08.2021).

[3] Directive 4 under Executive order No. 14024 "Prohibitions Related to Transactions Involving the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, and the Ministry of Finance of the Russian Federation". URL: https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions/20220228 (accessed on: 15.08.2022).

[4] Council Regulation (EU) No. 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine. URL: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02014R 0833–20220413 (accessed on: 15.08.2022).

funds — domestic and from neutral and friendly countries — into the Russian financial market and the real economy, and, on the other hand, limit the possibility of capital withdrawal from Russia not only for investors from unfriendly countries, but also from other categories. Finding the optimal model for raising capital domestically and directing it to work in the real economy, as well as limiting capital outflows, is no easy task. Nevertheless, such approaches are already in place, but so far, they are seen as urgent "firefighting" measures. It is thought that much of these instruments should be used in the development of new financial market strategy.

It should be noted that the Bank of Russia has prepared and submitted for public discussion key areas for financial market development in the sanctions' environment.[5] Nevertheless, this draft is rather restrained and does not always correlate with the decisions that the executive authorities and the Bank of Russia are currently adopting and implementing. On the one hand, this conservative approach helps to maintain a positive attitude among market participants, but on the other hand, the Strategy should not be limited to a purely inertial scenario and technical issues without responding (or at least attempting to respond) to the challenges faced by the Russian financial system. This document notes that the financial sector is capable of restoring financial sustainability on its own over the medium term, and that systemic additional capitalisation of the financial sector (including the banking sector) is not required. In fact, it is up to the owners of the credit institutions to support them. For example, market participants are taking various initiatives regarding blocked assets. The Bank of Russia's position is that the option of buying blocked assets from financial institutions is not a solution but will only lead to a massive money issue. While agreeing with this approach in principle, it is still advisable to consider a more flexible one, given some experience of restructuring bad assets through long-term recapitalisation of individual banks, transactions under the Banking Sector Consolidation Fund, as well as funding and advisory support from state development institutions, etc.

NEW STRATEGIC OPPORTUNITIES FOR FINANCIAL INFRASTRUCTURE DEVELOPMENT

When working out the strategy of financial market development in the new conditions, it is important to rely on the approaches formulated in the works of M. Porter on competitive advantages [3], H. Prahalad and G. Hamel on key competences [4], V.L. Kvint on the strategy of cardinal transformations [5], M. Castells on the information society [6], R. Grant on strategic analysis [7], and also develop the ideas of A.D. Nekipelov [8], S. Yu. Glazyev [9], M.G. Deliagin [10], Y.M. Shvirkov [11], Yu.V. Yakovets [12], etc.

The pandemic has exacerbated distortions in the reflection of the real economy's performance in financial indicators. Central banks are focused on supporting liquidity and preventing financial crisis, but building effective boundaries to ensure that liquidity flows into investments and consumptions, rather than spilling over into the financial market and speculation, has so far failed.

However, the liquidity support provided by the central banks of developed countries does not address the lack of tangible assets and long-term resources for development. In this context, some isolation of the Russian economy from unhealthy trends will at some stage allow it to concentrate on solving its own problems, which, paradoxically, complies with the national interest.

[5] The financial market: new challenges in today's environment. A document for public discussion. Bank of Russia. 2022. URL: https://cbr.ru/press/event/?id=14062 (accessed on: 04.08.2022).

High energy prices in recent years and increasing efficiency in the extractive industries have enabled the build-up of reserves and savings. Some of these have been invested domestically (including in the implementation of infrastructure projects), but a significant proportion of reserves and savings has been taken abroad to acquire assets. In addition, the savings of Russian residents and the state in foreign financial instruments (currencies, foreign securities, etc.) also grew.

The difficulty in investing domestically is due to a combination of factors, including the prevalence of short-term savings over long-term savings and the lack of investment opportunities themselves in the country. However, the impact on Russian residents of the Bank of Russia and Sovereign Wealth Fund reserve allocation model, implied investments in foreign jurisdictions, should not be underestimated. A number of investors are willing to invest in projects with a justifiable level of risk (not only in fast-payback projects, but also in the medium term) if there is sustainable demand, including through government procurement or guarantees. Infrastructure in major cities is being modernized, housing construction is growing, etc. However, more complex projects with a long-term perspective and innovative development are often slowed down. In fact, there is a vicious circle: breakthrough projects cannot find long-term financing, because the interests of capital owners are oriented towards quick payback in the short and medium term due to high risks. A parallel should be drawn here with Israel [13], where investors are also focused on short-term projects. The solution could be widening public-private partnerships and the development of new financial platforms.

The financial system development strategy presented by the Bank of Russia,[6] continues to rely heavily on the liberal economic paradigm. In the current environment, a more determined approach is needed to ensure development within a rather closed financial system, relying on an active role of state institutions. While the principle of the Bank of Russia's independence from the executive power was previously supported by most practitioners and experts, in the current situation the Banks of Russia subordination to the Russian government should be considered. Nevertheless, autonomy in the area of monetary policy should be retained.

The imposition of sanctions by a number of developed countries in February 2022 necessitated a fundamental transformation of the Russian financial market. In fact, the trend towards the disintegration of the modern economy has taken hold. The restrictions affected many Russian investors in terms of their foreign investments, as well as foreign investors with assets in the Russian financial system. In particular, a special military operation led to a sharp fall in the value of Russian securities, which was the result of an attempted rush to sell off Russian assets by foreign investors. This fall was exacerbated not only by increased political and economic risks, but also by emotional factors, resulting in the decision to temporarily halt trading on the Moscow Exchange.

Securities trading on the Moscow Exchange has gradually resumed and is demonstrating a positive trend. Thus, the total volume of trade in financial market instruments (shares, corporate bonds, exchange-traded bonds, ownership units, OFZ (federal loan bonds), etc.) on the Moscow Exchange in January 2022 amounted to 37.1 trillion rubles, in July — 41.9 trillion rubles, in October — 46.4 trillion rubles,[7] despite the fact that the total amount of trading in foreign securities and depositary receipts has not been resumed.

[6] The financial market: new challenges in today's environment. URL: https://cbr.ru/press/event/?id=14062 (accessed on: 04.08.2022).

[7] Author's calculations based on data from the Moscow Exchange. URL: https://www.moex.com/s1443 (accessed on: 15.11.2022).

The crisis calls for an expansion of the functions of the economic departments of the executive branch and of central banks. However, whereas previously the principle of independence of central banks was realised, the concept of independence is now being diluted, even at the supranational level. The US Treasury has imposed restrictions on any transactions with the Bank of Russia, the Ministry of Finance, and the National Welfare Fund,[8] effectively blocking government reserves. Similar restrictions have been imposed by the EU and a number of other countries. Thus, at the international level, the Bank of Russia is already perceived as part of the state system. In such circumstances the advisability of preserving the principle of full independence of the Bank of Russia should be determined not by theoretical concepts, but by national interests. Moreover, certain restrictions on the independence of central banks (except for monetary policy) seem logical not only in emergency situations, but also in the medium term. For instance, the People's Bank of China is accountable to the State Council of the People's Republic of China.[9]

The competitive advantage of the Russian financial market until recently was compliance with international requirements in terms of its infrastructure, trading principles, information disclosure, etc., and Moscow Exchange and the National Settlement Depository met the principles for financial market infrastructures developed by BIS Bank for International Settlements and the International Organisation of Securities Commissions (IOSCO).[10] This met the requirements of a qualified intermediary, the US Securities and Exchange Commission (U.S. Securities and Exchange Commission's Rule 17f-7).

Nevertheless, the new situation faced by the Russian economy implies a priority development of the domestic financial market (with reliance on Russian investors, trading on a fully pre-deposited basis, a less complex risk management system, some restrictions on the ability of unqualified investors to invest in foreign financial instruments, etc.). Making it easier for issuers, especially in Russian regions, to enter the market during the crisis implies lower disclosure requirements. Such conditions will attract to the Russian stock market regional companies whose owners preferred not to carry out corporatization and not to bring their organizations to the financial market because of their unwillingness to share power with new shareholders. In addition, such a financial market model is suitable for Russian companies subject to sanctions.

In this context, it seems justified to use two models of financial infrastructure in parallel. The first could be based on generally recognized international principles and target retail investors from Russia and friendly countries, and the main securities could be instruments issued by federal and regional companies that are not under sanctions. The second, simplified model involves less sophisticated risk management and limited disclosure, which is more suitable for qualified investors willing to invest in companies under various restrictions, regional organizations, etc. The parallel existence of the two models is, in fact, still possible, as differentiated requirements for different sections of the Moscow Exchange are allowed. However, to improve the efficiency of the second model, given its focus on regional specifics, we consider it justified to create several exchanges in key regions or at the level of federal districts.

[8] Treasury Prohibits Transactions with Central Bank of Russia and Imposes Sanctions on Key Sources of Russia's Wealth. URL: https://home.treasury.gov/news/press-releases/jy0612

[9] Article 2. Law of the People's Republic of China. URL: http://www.pbc.gov.cn/eportal/fileDir/english/resource/cms/2015/08/2015082610501049304.pdf (accessed on: 17.08.2022).

[10] Principles for financial market infrastructures. URL: https://www.bis.org/cpmi/publ/d101.htm (accessed on: 15.02.2021).

Increasing the number of exchanges, digital financial platforms and other institutions in the Russian financial market is important in the current environment, given that sanctions from Western countries have begun to extend to systemic financial institutions, including National Settlement Depository).[11] But also in the medium term, if two models for the Russian financial market are to be developed, the National Settlement Depository could retain its unique position for the former, while a simplified model should offer greater variability.[12]

At the same time, it is important to continue to develop commodity exchange markets in the regions and Russian price indicators. The Bank of Russia is actively working on this.[13] Domestic prices for many commodity groups follow global prices, but in the new environment of a partially isolated financial market, they may differ between the global and Russian commodity markets due to limited arbitrage opportunities and the lack of working links between commodity exchanges and partner countries.

INITIATIVES TO REDUCE CAPITAL FLIGHT (OUTFLOW)

Restrictions on cross-border capital movements are not only a forced measure due to the current situation, but most likely a belated initiative that should have been implemented years ago. Traditionally, regulation is based on universal principles, while the differentiated approach is used in a limited way. Nevertheless, capital movements should be controlled not only when transactions are linked to offshore jurisdictions, but also depending on the country of origin of the capital, the purpose of its use, etc. In part, this approach is already used in the activities of the sub-commission of the Government Commission for the Control of Foreign Investment in the Russian Federation, where each transaction is considered individually.

In times of crisis, investors, especially non-residents, tend to withdraw capital from emerging markets, which further increases pressure on the national currency exchange rate. In this connection, it is advisable to introduce more flexible regulations and restrictions on non-residents, for example, to close no more than 20–30% of positions during each quarter. In the current crisis situation, severe restrictions have been imposed on capital outflows in response to the freezing of certain Russian assets by a number of countries. However, in the longer term it seems justified to consider capital outflow limits (as a percentage depending on previous investments made) as well as a number of other measures. The regulatory framework laid down in 2022 could be adjusted so that permits for cross-border capital movements are not issued in relation to individual transactions but based on the volume of investment projects implemented over the previous 2–3 years, which would eventually allow for annual limits on the withdrawal of capital for large companies.

The purpose of capital controls is not to prohibit the withdrawal of capital, but to create a transparent system that allows for differentiated limits.

Many economists have long called for restrictions on the cross-border movement of speculative capital [14]. There are various instruments for implementing this initiative, from currency controls to a Tobin tax or

[11] Council Decision (CFSP) 2022/883 of 3 June 2022 amending Decision 2014/145/CFSP concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine. URL: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022D 0883 &from=EN (accessed on: 09.05.2022).

[12] The provision of Federal Law No. 39-FL of 22.04.1996 “On the Securities Market” stating that only a central depository may be a nominee holder of securities in the register needs to be clarified.

[13] URL: https://www.moex.com/n49899?ysclid=l70b4rutf2551906644 (accessed on: 01.08.2022).

a tax on non-tradeable foreign exchange transactions.[14] We believe that both administrative and fiscal approaches can be used. For instance, modified Tobin tax may be rather high — up to 2% and be applicable only to currency exchange transactions against reserve currencies, while counter transactions should not be subject to it. It should be understood that financial institutions making transactions on behalf and at the expense of their clients will not be affected by the introduction of this tax. Losses will be incurred by importers and consumers, who will have to pay higher prices for imported goods. However, the reduction of speculative transactions will increase the stability of the national currency and eventually attract long-term investments into the country.

In 2022, capital withdrawal limits were set for non-residents. But more flexible regulation could impose restrictions (varying according to investment characteristics, macroeconomic situation, etc.) on non-resident investors' capital withdrawal, e.g. setting a percentage on the ability to close positions and withdraw capital within one quarter. The aim is to prevent uncontrolled capital flight in times of crisis, not to prohibit capital outflow altogether.

It was noted earlier that trading volumes in the stock market are gradually recovering. But the foreign exchange market is also undergoing transformational changes. Thus, until recently, reserve currencies, including US dollars, euros, etc., accounted for the largest volume of trading on the Moscow Exchange. New external conditions are changing the structure of demand from participants of foreign economic activities: the volume of trade in Chinese yuan, Hong Kong dollar, Belarusian ruble, Kazakh tenge and Turkish lira increased many times. New currencies, including the Armenian dram, South African rand, and Uzbek sum, are being traded.[15]

Government and private savings in toxic currencies are associated with high risks, so there is some potential for investments in gold, precious metals, and soft currencies. Moreover, the export restrictions on Russian gold imposed by a number of countries,[16] will make it possible to increase its share in Russia's foreign exchange reserves more quickly. In this connection, it is advisable to expand state purchases of gold and promote investment in it as a source of savings for Russian residents.

The serious losses suffered by Russian private investors in Q1 2022 and the deprivation of many foreign investors from withdrawing capital suggested that the Russian stock market would stagnate. However, this hypothesis has not been fully confirmed in practice. Investors, especially those working with high leverage, have indeed suffered significant losses and are unlikely to return to the stock market quickly. At the same time, those who have not leveraged and have a balanced portfolio have remained in the stock market, despite the losses, and their activity is gradually recovering. This is to some extent due to the narrowing of investment opportunities and the inaccessibility of foreign securities to Russian retail investors.

It should be noted that the anti-crisis measures taken have calmed the financial market, but some measures were hasty and should not be used as a basis for a new financial architecture. For example, the sanctions imposed on Russian banks and financial infrastructure organisations required the transfer of foreign securities of clients from large SDN-listed banks to other non-sanctioned

[14] Report by S. Y. Glazyev, EEU Minister for Economy and Macroeconomics, "On forecasts of global economic dynamics under the COVID-19 pandemic and possible stabilisation measures within the EEU". URL: https://rcbc.ru/wp-content/uploads/2021/04/2020–04–14_eaes_covid-19–3–12.pdf (accessed on: 10.08.2021).

[15] URL: https://www.moex.com/n48383/?nt=0 (accessed on: 12.07.2022).

[16] Press-release UK sanctions Russian gold exports. URL: https://www.gov.uk/government/news/uk-sanctions-russian-gold-exports (accessed on: 21.08.2022).

Russian companies. Such a move was expected to allow Russian clients of sanctioned banks to continue to conduct transactions with foreign financial instruments and receive income from them. On 18 March 2022, the Board of Directors of the Bank of Russia decided to establish a temporary procedure for transferring securities of foreign issuers by persons in respect of whom foreign states commit unfriendly acts. However, the hastiness of this measure did not protect the interests of investors, who were already suffering high losses. Although it is difficult to speak of the interests of security holders in this situation, decisions made by the regulator should still not destroy investor confidence and market principles, even in such difficult times. In this respect, the transfer of securities on the basis of decisions by sanctioned credit institutions can be seen as an exceptional measure. Centralisation and speedy decisions should not replace private initiative, because it is inherently investors' right to choose the depositary and bank where they prefer to keep their securities and cash, and the brokerage company with which they themselves prefer to cooperate.

One long-term strategic initiative could therefore be connected with the imposition of some limits on the share of foreign securities in retail investors' portfolio. At least in the case of an individual investment account (IIA) for which an individual receives tax deductions, some limits on the share of foreign securities in the entire portfolio seem reasonable. It is important for private investors to understand that in the new environment holding foreign securities is associated with additional risks, although a complete ban on transactions in foreign financial instruments for unqualified investors (proposed in the Concept of the Bank of Russia to Improve the Protection of Retail Investors[17]) seems unnecessary.

[17] Concepts to improve retail investor protection. URL: https://cbr.ru/StaticHtml/File/41186/20220720_concept.pdf (accessed on: 21.08.2022).

The increased risks of operating in foreign jurisdictions affect not only investors but also issuers. The difficulty is that a number of Russian companies, such as Yandex, Tinkoff, Polymetal, X5 Group, VK (formerly Mail Group), etc., have issued and placed securities outside the Russian Federation on behalf of their subsidiaries and therefore are not subject to Russian regulation. As a result, Russian investors holding their shares have, in effect, become dependent on a foreign depository system in which their assets and the proceeds from the securities are locked up. In this context, Russian issuers (and companies set up by them in foreign jurisdictions) should strive to have their securities held in the Russian depository system (tier one) regardless of the country of circulation, with Russian banks acting as paying agents.

ANTI-CRISIS MEASURES AND IMPROVEMENT OF FINANCIAL AND FOREIGN EXCHANGE REGULATIONS

The unprecedented pressure of the sanctions has led to extraordinary solutions in the financial and monetary sphere, which have already proved their worth in the short term. On this basis, we believe it is justified to adapt certain measures for the longer term as well.

Presidential Decree No. 79 of 28 February 2022 "On the application of special economic measures in response to unfriendly actions by the United States of America and associated foreign States and international organizations" established a number of important decisions, including:

- measures of obligatory sale of foreign currency proceeds [residents-participants in foreign economic activities should carry out obligatory sale of foreign currency in the amount of 80% of the amount of foreign currency, credited to their accounts in authorised banks (later, by the Decree of the President of the Russian Federation of

23.05.2022 № 303 this limitation was reduced to 50%, and then — to 0%%[18])];

• prevention of capital flight (prohibition of foreign currency loans by residents, prohibition for residents to transfer money to foreign banks).

Presidential Decree of the Russian Federation No. 81 of 01.05.2022 "On Additional Temporary Economic Measures to Ensure Financial Stability of the Russian Federation" established additional restrictions on transactions with securities and real estate, as well as the granting of loans to non-residents. At the same time, the possibility was given to carry out such transactions on the basis of permits issued by the Government Commission for Control over Foreign Investments in the Russian Federation. A ban was imposed on the export of foreign currency in cash in an amount exceeding USD 10 thousand.

Also, decree No 95 of the President of the Russian Federation of 05.03.2022 "On temporary procedure for the performance of obligations to certain foreign creditors" was adopted, which allows residents to perform their obligations to non-residents in roubles in the amount equivalent to the value of obligations in foreign currency to special accounts of type "C". Securities are similarly credited to "C"-type accounts.

Presidential Decree of the Russian Federation No. 126 of 18.03.2022 "On Additional Temporary Economic Measures for Ensuring Financial Stability of the Russian Federation in the Area of Currency Regulation" grants powers to the Board of Directors of the Bank of Russia to determine the amounts of advance payments to non-residents, defines the powers of the Governmental Commission for Monitoring Foreign Investment in the Russian Federation.

Decree No. 172 of the President of the Russian Federation of 31.03.2022 "On the Special Procedure for Performance of Obligations by Foreign Buyers to Russian Natural Gas Suppliers" allows the use of special rouble and foreign currency "K"-type accounts for gas payments.

Russian Federation Eurobonds special capital flow regulation regime is based on the use of type "I" accounts in accordance with the Russian President's Decree No. 394 "On Temporary Order of Execution to Residents and Foreign Lenders of Russian Federation Government Debts Expressed in Government Securities with Foreign Currency Denomination" dated 22.06.2022. The use of the special treatment allows to settle in priority with Russian holders of Eurobonds [holders of Eurobonds whose holding rights are accounted for by the National Settlement Depository (NSD) or Russian depositories without foreign depositories, the so-called first group, as well as the second group, i.e. holders of Eurobonds whose holding rights are accounted for by Russian depositories with foreign depositories involved] with the remaining funds being transferred to the Type "I" account.[19]

To discharge and fulfill liabilities and obligations towards non-resident holders of Eurobonds of corporate issuers, there is a possibility to use "D" accounts (on the basis of permits issued by the Bank of Russia or the Governmental Commission for Control Over Foreign Investment in the Russian Federation), the legal basis of which is provided by the Presidential Decree of the Russian Federation No. 529 of 08.08.2022 "On Temporary Order

[18] Extract from the minutes of the meeting of the sub-commission of the Government Commission for the Control of Foreign Investment in the Russian Federation of 09.06.2022 No. 61. URL: https://minfin.gov.ru/ru/document/?id_4=136373 (accessed on: 20.08.2022).

[19] On the new procedure for making payments on Russian Federation Eurobonds. URL: https://minfin.gov.ru/ru/press-center/?id_4=37998-o_novom_poryadke_osushchestvleniya_vyplat_po_yevroobligatsiyam_rossiiskoi_federatsii (accessed on: 02.11.2022).

of Performance of obligations under bank account (deposit) agreements denominated in foreign currency and obligations under foreign currency exchange contracts". Also, this Decree allows Russian banks facing blocking of assets in foreign banks to suspend performance of obligations to legal entities with regard to performance of transactions with funds in blocked foreign currencies received in bank accounts of legal entities after this Decree enters into force.

It should be noted that these decisions made it possible to control the use of foreign currency proceeds promptly and to limit capital flight, but some of the restrictions were subsequently adjusted. Decisions taken by the sub-commission of the Government Commission for the Control of Foreign Investment in the Russian Federation could be gradually reoriented from approving individual transactions to setting annual limits on capital movements for large companies and banks. Moreover, in the medium term, decisions on small amounts could be entrusted to large banks, which could issue approvals within the limits set to each bank by the regulator.

The difficulties with foreign trade settlements faced by large Russian companies force them to look for alternative schemes. For example, when making payments to foreign counterparties, Russian companies can use accounts in foreign banks belonging to their foreign subsidiaries. Such a scheme allows payments to be made, including in US dollars and euros, but the assets are not returned to the Russian economy and remain abroad. This further increases the risks from blocking Russian assets in foreign jurisdictions.

Businesses are also trying to resolve issues with the blocking of foreign shares belonging to Russian investors. For example, an Investor Protection Club was formed on the Moscow Exchange, which is a single information space for market participants and is intended to defend investors' interests in the context of sanctions imposed on the National Settlement Depository.[20]

The Bank of Russia is taking important decisions, among which are the following:

- simplification of regulatory requirements for banks and non-credit financial institutions (reflection of equity and debt securities acquired before 18 February 2022 at fair value as of 18 February 2022 in accounting as well as for calculation of a number of Bank of Russia ratios; fixing of creditworthiness ratings assigned by leading rating agencies (Standard & Poor's, Fitch Ratings and Moody's) as of 1 February 2022.;
- use of downgrade coefficients for borrowers subject to sanctions imposed by unfriendly countries; temporary reduction of disclosure by credit institutions);
- temporary restrictions on financial market transactions and income payments (trading on Russian stock exchanges was temporarily suspended and then resumed in stages; a temporary ban for brokers to execute securities sales transactions on behalf of non-residents; a temporary ban on short sales on the Russian financial market (adjusted); a ban for Russian depositories to transfer dividends to non-residents; recommended postponing dividend and management remuneration payments);
- monetary policy and operations to support banks' liquidity (the issuance of cash in foreign currency from deposits has been restricted (the temporary procedure is valid until 9 March 2023); the refinancing rate has been raised to 20% (the rate was subsequently significantly reduced); limits on currency swaps have been increased, and the Lombard (pawnshop) list has been expanded).

An instruction from the Bank of Russia to professional securities market participants engaged in depository and register-keeping

[20] URL: https://www.moex.com/n52269/?nt=106

activities suspended the transfer of payments on securities of Russian issuers to foreign individuals and legal entities.

The Bank of Russia has also recommended limiting the sale of foreign securities to unqualified investors.[21] Such approach seems justified for the current situation, although a complete ban seems unnecessary in the medium term. Some restrictions on the purchase of foreign securities for Russian investors are a measure that could be formulated more flexibly, e.g., placement of funds in foreign financial instruments should not exceed 40% of the total financial market investment portfolio (for each brokerage account), and control over compliance with this requirement should be imposed on professional securities market participants.

The mega-regulator's high adaptability to external changes is a good quality, but the monetary authorities' policy could have been more consistent, aimed at increasing confidence in the Russian rouble and the regulator's decisions.

Overall, the measures taken by both the government and the regulator were broad enough to reduce uncertainty and risk in the Russian financial system. The Presidential Decrees of the Russian Federation aim to prevent certain channels for both Russian and foreign investors to withdraw capital from Russia. Restrictions were introduced for foreign creditors to withdraw assets from the Russian financial system. This approach has relieved panic in the financial market and reduced the negative impact on investors, issuers, and the Russian financial system as a whole. At the same time, these actions were a response to the restrictions imposed by a number of foreign countries on Russian residents to use Russian assets in foreign jurisdictions.

The temporary procedure for Russian residents to fulfil their obligations under loans, borrowings, and financial instruments (including Eurobonds) to foreign creditors from unfriendly countries reduced the outflow of foreign currency. However, difficulties in making foreign currency payments and the effects of anti-crisis measures increased the risks of default by Russian companies, which in a normal scenario would have been unlikely. A number of companies continued to pay their debts in foreign currency after obtaining approvals from the sub-commission of the Government Commission for the Control of Foreign Investment in the Russian Federation.[22] However, despite the performance by Russian companies of their obligations to the extent envisaged by the issue documentation, Russian investors who held their debt through the Eurobonds were unable to receive the funds due to Euroclear, Clearstream and/or payment agents refusing to settle in favour of NSD (National Settlement Depository) and its clients.

To solve this problem, borrowers/issuers of Eurobonds were advised to make payments on them to Russian holders directly, without transferring funds to international settlement and clearing systems. Alternatively, early redemption of Eurobonds from holders with settlement in roubles through the Russian securities market infrastructure was proposed.

The case study shows that issuing companies remain vulnerable to defaults by the financial market infrastructure and that default risks increase significantly in the face of external shocks, not only due to the state of the company itself. In this regard, it is important that the strategy for the development of the Russian financial market includes improvements in the depository and settlement infrastructure. Russian issuers'

[21] Letter of the Bank of Russia No. IN-018–59/94 of 20.07.2022. URL: http://cbr.ru/Crosscut/LawActs/File/5955 (accessed on: 28.07.2022).

[22] This Sub-Commission is authorised to decide on authorisations for residents to carry out transactions with foreign persons of unfriendly states, as well as to carry out foreign exchange transactions.

securities (regardless of where they are held) should be recorded at the basic level by the Russian depository system, and payments should be made by Russian banks. Domestic investors should also seek to hold financial instruments in Russian financial institutions. If they opt for another jurisdiction's record-keeping system, they bear additional risks.

In accordance with Federal Law No. 114-FL of 16.04.2022 "On Amendments to the Federal Law "On Joint-Stock Companies" and Certain Legislative Acts", circulation of depositary receipts for shares of Russian issuers outside the Russian Federation will be terminated, i.e., in fact, we are talking about delisting depositary receipts of Russian issuers placed on foreign stock exchanges. This law is intended to protect Russian issuers and investors from the unlawful actions of foreign clearing and settlement systems in the context of sanctions on the Russian Federation, as well as to increase trading volumes on the Russian stock exchange. It should be noted that issuers still have the option of obtaining permission to continue circulating ADRs on foreign markets.

In the new environment, the Russian financial market must first and foremost serve the national interest and be attractive to Russian private investors. This approach requires the expansion of the number of products, the entry of new issuers (federal, regional, foreign from neutral countries) to the Russian stock exchange, an increase in institutional investors, etc. Active work is under way to improve legislation to develop instruments for long-term savings by individuals, as well as mechanisms to stimulate such savings.

THE NEW ROLE OF INTERNATIONAL FINANCIAL INSTITUTIONS

The special military operation in Ukraine and the extensive sanctions against the Russian economy and its energy sector have led to rising inflation, including in developed countries. In this context, it is expected that many countries will move towards tighter monetary policy, raising interest rates, cutting budget spending and budget deficits. Although the US Federal Reserve has raised the refinancing rate to 3.75–4%,[23] reducing budget spending has not yet become a strategic priority in the US, which reduces the credibility of the US financial system.

It should be noted that easing policies are effective in times of crisis and emergency, but their application must be limited in both volume and duration. The current increase in US interest rates with high debt levels destroys the balance of the US financial system. Moreover, the blocking of dollar reserves by the Bank of Russia is undermining confidence in the dollar and more and more countries are choosing to settle and save in alternative currencies.

It is quite justified that Russia has stopped following blindly the economic decisions of developed countries and is trying to build its own financial strategy. After all, complex challenges require going beyond the standard tools of fiscal and monetary policy. The need for greater synchronisation of monetary and macroeconomic policies implies expanding the functions of the financial regulator in stimulating the economy as well as increasing the central bank's control by the government (in areas unrelated to monetary policy).

The gradual displacement of the US dollar by national currencies in foreign trade in the longer term involves building new supranational financial institutions, expanding the number of reserve currencies, and forming a supranational currency. In this process, it is important to rely on regional groupings such as BRICS (Brazil, Russia, India, China, and South Africa), the EAEU

[23] URL: https://www.federalreserve.gov/monetarypolicy/files/monetary20221102a1.pdf (accessed on: 02.11.2022).

(Eurasian Economic Union) and the SCO (The Shanghai Cooperation Organization), gradually promoting these initiatives at the global level. Nevertheless, the need to reform the world's financial institutions, primarily the World Bank and the IMF, seems increasingly urgent.

The initiative to establish a new world bank, with the ability to independently issue a new world currency, will not be supported at present, above all by the US. Nevertheless, the debt crisis, which will eventually affect many countries, will lead to massive losses, including the depreciation of US dollar reserves. Countries affected by US sanctions and those whose savings in US dollars will therefore be devalued will be able to push for reform of the world's financial institutions.

Advances in information technology are already making it possible to issue a supranational digital currency. Its key advantage over Special Drawing Rights (SDRs) issued by the IMF is that it can be used as a means of payment and savings by a wide range of economic agents, not just states and central banks.

Initially, the new digital currency, like the SDR, may be used by central banks exclusively for reserve purposes, but later its functions may expand (issuing securities denominated in this currency, first by global organisations and national governments, and later by corporations when entering the global capital market). To encourage the use of the currency in international settlements instead of the US dollar and other national currencies, the digital form (digital money) will be optimal. In essence, the advantage of the new digital currency over the dollar is the independence of the supranational issuing centre from the economic policy of states, the impossibility of imposing unilateral sanctions, greater financial stability (initially, the value of the currency can be calculated based on a basket of currencies, gold and other reliable assets) while maintaining oversight to prevent illicit transactions. This currency could gradually displace private cryptocurrencies as well (with a ban on cryptocurrencies at the supranational level). The practical implementation of this initiative is a daunting task, but the increasing systemic risks around the world, the growing probability of default even for sovereign debts of developed countries, give this initiative a more serious consideration.

CONCLUSIONS

External conditions require institutional reforms and a transition to a new strategy for financial market development. Traditionally, hard reserve currencies and gold have always been viewed as reliable reserve assets, but sanctions are changing the way we evaluate savings opportunities by channeling reserves into alternative assets: gold, soft currencies, etc. In the long term, it is advisable to consider the possibility of creating a supranational digital currency that is less subject to sanctions pressure. The most important task that remains is to increase investments, including through the use of mechanisms for citizens to invest in various projects with the participation of state development banks.

The establishment of flexible limits on the withdrawal of capital is aimed not only at reducing its speculative outflow, but also at stimulating domestic investment.

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