Minutes of the 10th meeting of the Working Group on Money Market Indices (MMWG)

June 22, 2022, Almaty

On June 22, 2022, the 10th meeting of the Working Group on Money Market Indices (hereinafter – Working Group) was held in Almaty with the participation of representatives of the National Bank of Kazakhstan (NBK), European Bank for Reconstruction and Development (EBRD), JSC "Kazakhstan Stock Exchange" (KASE), Association of Legal Entities "Association of Financiers of Kazakhstan" (AFK) and second-tier banks (banks).

According to the Agenda the following issues were discussed during the meeting:

I. The NBK gave a brief overview of the money market situation in Kazakhstan:

1. The NBK informed that the banking system continues to operate with excess liquidity.
2. The NBK reported that TONIA is within the base rate corridor. The NBK's participation in the repo market has declined from around 80-90% in early 2019 to the level of almost 30% in 2022.
3. In 2020, the NBK participation in the 1-day swap market increased as the Fed started to cut rates in early 2020. As the Fed has started to raise the base rate, the NBK participation in this market is expected to decline this year.
4. The NBK has suspended the issuance of semi-annual notes starting from the second quarter of 2022. The NBK is exploring whether to stop issuing 91-day notes.
5. The NBK will send a money market questionnaire to the Working Group participants.

II. The EBRD provided a global overview of derivatives market developments.

1. The EBRD briefed the participants of the Working Group on the importance of interest rate derivatives.
2. The EBRD informed that OTC derivatives are the most intensively used instruments in the bank-client relationship and that the use of risk-free SOFR rates has increased.
3. The EBRD noted that foreign exchange derivatives outnumber interest rate derivatives in derivatives trading in emerging markets.

III. The EBRD has provided guidance on the development of the derivatives market in developing countries.

1. The EBRD, based on a publication by the International Swaps and Derivatives Association (ISDA), noted the practicality of interest rate derivatives in that interest rate derivatives can convert fixed rates into floating rates.

2. The EBRD talked about the close-out netting process and its importance. In particular, the execution of netting reduces credit risk between counterparties and is also a key tool to reduce credit risks associated with OTC derivatives. Netting is an important component of hedging by financial institutions and other derivatives’ users.
3. The EBRD has noted the need for legal agreements between counterparties. For example, the ISDA Master Agreement (Master Agreement) is a standard contract that can be amended bilaterally through the signing of an ISDA Annex which modifies certain terms applicable in bilateral transactions. The Credit Support Annex (CSA) regulates collateral under the ISDA Master Agreement, defining the terms and conditions under which collateral is posted to reduce counterparty credit risk.

IV. The EBRD provided an overview of the responses to the questionnaire on the legal and regulatory framework for derivatives in Kazakhstan.

1. The EBRD informed that according to the legal consultant's assessment, Kazakh legislation does not provide guidance on how derivatives should be valued. According to the banks' responses they use market data to value swaps. However, as is known, Kazakhstani banks do not enter into all types of derivative transactions.

   One bank shared an opinion that there are limitations on this issue. Thus, the lack of a clear understanding of the documentation, including the absence of netting options, is holding back the execution of interest rate derivatives transactions. As far as is known, the current local legislation does not cover details regarding the mark-to-market process. Moreover, this problem regarding the mark-to-market process will remain open until there is sufficient liquidity in the instruments and trading interest rate derivatives through an exchange would be a good way to increase liquidity.
2. The EBRD reported that there are no regulatory restrictions for banks to enter into derivative transactions, but there is an understanding that not all types of investors can participate in the derivatives market. Banks can only participate if they have a broker and dealer license. Obtaining a broker and dealer license has become simplified, but nevertheless the list of derivatives is not always up to date and is a constraint on the market.
3. The EBRD has noted that certain investors cannot enter into derivative transactions for risk insurance purposes, but the Agency of the Republic of Kazakhstan for Regulation and Development of Financial Market (Agency) and the banks have confirmed that there is no such restriction.
4. Regarding questions about whether derivatives will be treated differently from bonds under FRTB (fundamental review of the trading book) and whether and how the IRRBB (interest rate risk in the banking book) is being implemented, the EBRD noted that under the regulatory constraints according to the Basel framework there is an emerging need for risk assessment on banks' balance sheets. The Agency said that by the end of the year it will work on changes to

the legal and regulatory acts and the methodology, and on revising the transit period during which banks will have to bring their balance sheets into line.
One bank confirmed that FRTB and IRRBB have been implemented globally for a long time in their system, and in general, of course, the classification of securities makes it easier to bring them into FRTB than interest rate derivatives. But in terms of global rules and policies, this is quite possible.

5. The EBRD said that according to the Agency, derivative transactions are not included in the list of transactions that are not taxable, so any derivative transactions will be taxed regardless of whether they are exchange-traded or over-the-counter. Representatives of KASE also confirmed this information.

V. The EBRD explained the procedures in the case of OTC derivatives.

The EBRD shared that for OTC derivatives transactions the following steps take place: signing of the ISDA Master Agreement and the Credit Support Annex; determining the need to manage interest rate risk; assessing the potential transaction risk and available credit lines for the transaction; discussing with the counterparty the structure and price of the transaction; closing the transaction; evaluation of the transaction on an ongoing basis; managing the collateral.

VI. On holding the next MMWG meeting.

1. Parties agreed to hold the next meeting of the Working Group in September 2022.
2. Specific dates and venue of the next meeting to be agreed upon.