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

October 7, 2022, Almaty

On October 7, 2022, the XI 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.

The NBK informed that the banking system is still operating with excess tenge liquidity, the main instrument for liquidity withdrawal being the NBK notes. The NBK has steadily reduced the issues of notes (only 28-day notes remain in circulation), and from Q4 2022 it switched to a less frequent auction of notes. The NBK also notified that the TONIA indicator continues to form within the interest rate corridor.

II. The NBK provided an overview of the banks' responses to the money market questionnaire.

One of the reasons for the underdevelopment of the interbank market is the lack of limits on counterparties. There is also a certain lack of trust in dealing with counterparties, as well as restrictions in terms of prudential regulation (k3). Despite the higher rate on NBK notes, the withdrawal of excess liquidity through NBK notes is limited by banks' ability to forecast unexpected withdrawals of deposits by large customers, as well as the low frequency of note auctions (once every fortnight). Banks have no problems in redirecting liquidity between repo and NBK deposits.

Banks use averaging mechanisms to meet minimum reserve requirements. Banks apply regular liquidity horizon assessment and build forecasts for the short and long term, which are also regulated and monitored on a daily basis, while for the longer term a gap analysis is built for a horizon of six months or a year.

III. The EBRD provided an overview of banks' responses to the derivatives market questionnaire.

1. Banks provided with answers and discussed various questions concerning the process of monitoring interest rate risk, the possibility for the front office system to book all (any) types of derivatives and the possibility for the back office system to assess (reassess) all (any) types of derivatives, the possibility for the

front office system to book transactions with compounding in arrears, using the compounded index (both on business and calendar days), experience in signing ISDA and CSA agreements, as well as enforceability of close-out netting in the case of bankruptcy in calculating credit risk and limits for derivative transactions.

2. The EBRD noted that now that the derivatives legal reform has been adopted, a model agreement to be concluded between local counterparties needs to be developed to ensure domestic derivatives will be enforceable.
3. The EBRD indicated that due to amendments to the legislation, close-out netting has become fully enforceable and credit exposures and limits must now be taking into account the netting.

IV. The EBRD presented practical examples of the benefits of Overnight Index Swaps (OIS).

The EBRD demonstrated that the use of OIS allows to:

- express interest rate expectations;
- manage credit risk and interest rate risk separately (which facilitates better pricing and more liquid cash instruments);
- manage pure domestic interest rate risk without having to buy/sell cash assets on the balance sheet and irrespective of currency liquidity.

V. The EBRD shared guidelines for the development of the OIS market.

1. The EBRD has shared a list of conditions needed to launch a derivatives market, these are a money market benchmark, market makers willing to price and execute derivatives, infrastructure, supportive legal environment and regulatory framework, market understanding of the benefits of derivatives, knowledge/training, product conventions.

   Next, a yield curve is needed to develop liquidity. Yield curve conventions and a model to price the fixed rate leg of OIS are needed to build a yield curve for OIS.
2. The EBRD presented the main frequently used OIS conventions for the fixed leg (day count, payout frequency, operating day adjustment, adjustments, calculation calendar, payment delay) and floating leg (day count, payout frequency, index, reset frequency, operating day adjustment, adjustments, calculation calendar, corrections calendar, payment delay).
3. The EBRD presented to the participants an example of model to price OIS. A more in-depth study of this topic is planned for the next meeting.
4. The EBRD outlined the process for creating an OIS market. Thus, the first step (before a ‘market’ reference OIS curve is available for market participants to use to determine their own rates, where they would be willing to pay or receive fixed rate under OIS transactions) is for market participants to develop their own internal OIS curve. Banks could use these internal curves to start quoting OIS for different (initially short term) maturities, ranging from 1 week to [1 year], thereby constructing a yield curve derived from market quotes. The banks could

then be required to transact regularly on the basis of their quotes (quoting executable quotes on a platform like Bloomberg). As the quoting banks execute OIS deals, liquidity in the OIS market will increase, which will encourage smaller banks to execute their own deals. Ultimately, growing liquidity in the OIS market will eventually lead to an active OIS market that achieves interest rate hedging benefits to financial institutions and corporates.