Legal Regulation of Citizens’ Investments in the Russian Financial Market

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Abstract—For a market economy, investing as a “process” is a multidimensional and complex phenomenon due to interaction in it of numerous parties. If we are to classify the parties by principle of supply and demand, there are two main categories: sellers and buyers, each of which is as multi-faceted as the investment process itself. The article examines the course of the investment activity formation in Russia, its growth and expansion in terms of enhancing accessibility of investment process to every citizen. The state regulation of investments shall imply direct involvement in the provision of favourable conditions for investments. The investment process is attractive to an individual when the result is shown and perceived as a profit. Therefore, the government that is interested in increasing investment should create a positive investment climate to boost citizens’ engagement in the country’s investment process. In recent years, there has been a growing popularity of the financial market among the public, in particular, due to the introduction of individual investment accounts (IA). The differentiation of investors into qualified and unqualified should also facilitate the influx of players into the financial sector and diversify it. And further, investments in securities of Russian enterprises will expedite the process of economic recovery.

Keywords—investments, securities, savings, financial market, qualified and unqualified investors, individual investment account, Russian legislation, banking, stock exchange.

I. INTRODUCTION

What is the financial market and investments?

Scientists of the Moscow School of Finance refer to the "financial market" as a market of loan capital - "a special sphere of economic relations, where the object of the transaction is the monetary capital provided in the loan, for which demand and supply are formed..." [1].

The St. Petersburg school of thought gives a different definition - "it is a market where the market redistribution is being realized of free monetary capital and savings between different objects of the economy through transactions with financial assets..." [2].

It should be noted that the Russian legislation does not prescribe a unified and clear definition of the financial market.

We will focus on the interpretation of the Central Bank of Russian Federation (hereinafter Bank of Russia) as the main financial market regulator. "Financial market...system of economic and legal relations involving the use of money as a means of accumulation and payment, circulation of financial instruments, as well as cultural and business environment in which financial market participants operate. The public function of the financial market is effective allocation of monetary resources and risks, and setting equitable prices for financial assets" [3]. The Bank of Russia is responsible for supervision, regulation and development in all sectors of the financial market: banking system, insurance sector, collective investments and pension savings, securities market, microfinance. It is also in charge of the financial market infrastructure - the work of rating agencies, exchanges, depositories and other parties.

Now, let us consider the concept of "investment" from a legal viewpoint.

Russian legislation defines the following: "Investment - funds, securities, other property, including property rights, other rights with monetary value, invested in the objects of entrepreneurial and (or) other activities for the purpose of gaining profit and/or achieving other beneficial effects" [4] and "investment activity - investment and implementation of practical actions for the purpose of gaining profit and/or achieving other beneficial effects" [4].

II. RESEARCH METHODOLOGY

Having reviewed the semantics, we now proceed to the main subject. What and how we can invest in the financial market?

For a market economy, investing as a "process" is not only multidimensional but also a very complex phenomenon. Many financial market participants interact with each other in the process. If participants are classified according to the principle of supply and demand, there are two main categories: sellers and buyers, each of which is as multifaceted as the investment process itself. For visual comprehension, we suggest to refer to a schematic representation of financial market participants below (Fig.1, Tab.1).

From the scheme outlined by the Bank of Russia, it is clear that in the country’s financial market investment resources can be both internal and external.
For the sake of simplified understanding, let us assume the investor's own funds as internal sources of investment and all the rest as external sources.

Since the subject of the research is dedicated to citizens (individuals), we shall review the legislation, the laws that concern anyone who intends to engage in investment.

**Fig. 1.** Key participants of the Russian financial market [5]

### TABLE I. **FINANCIAL MARKET PARTICIPANTS**

<table>
<thead>
<tr>
<th>SELLERS (supply)</th>
<th>BUYERS (demand)</th>
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</thead>
<tbody>
<tr>
<td><strong>On the credit market, which ensures the circulation of loan capital</strong></td>
<td></td>
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<tr>
<td>Lenders are engaged in sale of monetary assets (own and borrowed) A lender may be:</td>
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<tr>
<td>• the state,</td>
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<tr>
<td>• a commercial bank,</td>
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<tr>
<td>• a non-banking financial institution,</td>
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<tr>
<td>Borrowers, experiencing a lack of financial resources are ready to buy the right to their temporary use. A borrower may be:</td>
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<tr>
<td>• a legal entity,</td>
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<tr>
<td>• an individual,</td>
<td></td>
</tr>
<tr>
<td>• the state,</td>
<td></td>
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<tr>
<td><strong>In the securities market, which ensures the circulation of financial resources through the issuance, flotation and redemption of securities</strong></td>
<td></td>
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<tr>
<td>The issuers shall carry out the initial issue of securities. Issuer may be:</td>
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<tr>
<td>• legal entities (Bank of Russia, JSC, corporations, private enterprises, funds, etc.),</td>
<td></td>
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<tr>
<td>• public authorities.</td>
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<tr>
<td>Investors, invest their free capital and savings in securities. In the Russian securities market almost all categories of market subjects from individuals to the state can act as an investor.</td>
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<td><strong>At the currency market, which ensures the circulation of currencies, payment documents, nominated in foreign currency</strong></td>
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<td>The peculiarity of the currency market is that sellers and buyers are the same entities.</td>
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<tr>
<td>• The Central Bank (Bank of Russia) shall be a regulator of the internal foreign exchange market of the state, and shall purchase and sell, as necessary, to maintain economic and financial stability,</td>
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<tr>
<td>• commercial banks concentrate the money of the population, conducting the bulk of foreign exchange operations within the country,</td>
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<td>• enterprises, companies that perform settlements in foreign currency with counterparties,</td>
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<tr>
<td>• individuals who exchange currency independently in specialized institutions or employ intermediaries (brokers, dealers)</td>
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<tr>
<td><strong>In the insurance market, which carries out the circulation of insurance products and services</strong></td>
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<td>Insurers carry out all types and forms of insurance by assuming for a certain fee various types of risk with the obligation to compensate for losses in case of occurrence of insured event. Insurers can be:</td>
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<tr>
<td>• insurance firms and companies,</td>
<td></td>
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<tr>
<td>Policyholders, subjects of the financial market who buy insurance products and services to minimize their financial losses in case of occurrence of an insurance event. Insurers can be:</td>
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<tr>
<td>• individuals and legal entities</td>
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<td><strong>In the market of gold and other precious metals of platinum group, performing metal circulation, in various forms, including electronic lots</strong></td>
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<tr>
<td>Sellers (if there are excesses) and buyers (if there is a shortage of metal or for investment purposes) act as the same subjects:</td>
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<td>• the state as a miner of mineral resources,</td>
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<tr>
<td>• Central Bank, owner of stocks,</td>
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<tr>
<td>• commercial banks owners of assets,</td>
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<tr>
<td>• individuals and legal entities (hoarding)</td>
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Let us start with the Civil Code of the Russian Federation (part one), chapter 7 Securities. Article 142 defines a security as "...a share, a bill of exchange, a mortgage, an investment unit of an investment fund, a bill of lading, a bond, a check and other securities..." [6]. The chapter is dedicated to the classification of securities and regulation of relations pertaining to their ownership. The securities, in which a citizen (individual) can invest, shall be considered after analyzing the legal framework.

The following Federal Law which deserves our attention is "On Securities Market", №39-FL, dated 22.04.1996. Since its enactment, many revisions and amendments have been made, especially over the past five years. Why did we identify it as the significant one? In January 2015 the law introduced a new concept - Individual Investment Account (IIA) - "... an internal account, which is designed for separate accounting of cash, securities of an individual, obligations under contracts concluded at the expense of the given customer” [7], which allowed individuals to invest with the possibility of tax deduction. A citizen is exempt from Personal Income Tax (PIT) on his income under certain conditions. We will look at them further as well. The law has prescribed gradual replacement of securities with paperless ones. The concepts of "perpetual bonds” [7] and "preferred shares with priority in the list of the recipients of dividends” [8] have been introduced. Article 51.2., "Qualified Investors” has also undergone changes. Clause 9 recognizes an individual as a qualified investor in order to obtain an investment opportunity through an investment platform.

More than 20 years ago, in February 1999, the State Duma adopted the Law "On Protection of Rights and Legal Interests of Investors on the Securities Market". It explains the objectives of the Federal Law, Art. 1 "...to ensure state and public protection of the rights and legitimate interests of individuals and legal entities whose investment targets are equity securities (hereinafter - investors), as well as determining the procedure for payment of compensations and other forms of reimbursement of damages to investors - individuals, caused by unlawful actions of issuers and other securities market participants (hereinafter - professional participants) in the securities market” [10].

At the end of 2001 the State Duma passed the Law "On Investment Funds" which regulates economic relations arising in the sphere of attracting money or other assets through placement of shares and signing agreements on their management for the purpose of their further investment into other economic objects. The property of the fund is managed in the interests of the investor on behalf of the manager. The Article 10 of the Law has formulated the concept of a mutual investment fund as "...a separate property complex consisting of the property transferred to the trust management company by the founder(s) of the trust management with the condition...".

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of combining this property with the property of other founders of the trust management, and from the property received in the process of such management, the share in the ownership right for which is certified by a security issued by the management company” [12]. The Article 14 gives the concept of an investment unit (share), which is “…a registered security certifying the share of its owner in the ownership right to the property constituting the mutual investment fund (trust), the right to receive monetary compensation upon termination of the contract of trust management of the mutual investment fund with all owners of investment units of that fund (termination of the mutual investment fund)” [13].

One of the laws devised and approved for citizens at the beginning of the new millennium was Federal Law No. 111-FL, which came into force almost 18 years ago in July 2002 is “On investment of funds to finance the funded part of retirement pension”. The law is composed of 43 articles that identify the specifics of operations for the accumulation and investment of pension funds. The Law is designed to regulate operations in the area of formation of the funded part of the pension and its possible further investment. The law contains information on the particularities of control over the operations of formation of pension savings by the government agencies and society [14].

III. RESULTS AND DISCUSSION

In August 2019, the Federal Law No. 259-FL “On Attracting Investments through Investment Platforms and on Amendments to Certain Legislative Acts of the Russian Federation” came into force. Let us consider Article 7 of this law, which reflects the particular features of investment by individuals.

According to this article, an individual is given the opportunity to use any investment platform for investment with the provision “…not more than 600 thousand rubles” “… during one calendar year” [15]. Also according to the same article the restrictions do not apply if:

- Citizen (individual) is an IE (individual entrepreneur) or is recognized as a qualified investor by the investment platform operator. Taking into consideration the division of an individual into a IE and a mere citizen, we understand (and this is stipulated by law) that when using the investment platform, a citizen is not required to register as an individual entrepreneur.
- An individual acquires utilitarian digital rights under an investment agreement concluded with PJSC (public joint stock company).

The law also restricts the attraction of funds by one person to an amount not exceeding 1 billion rubles. There are also requirements to the investment platforms themselves, such as mandatory inclusion in the register of the Bank of Russia - the country’s regulator and the availability of equity capital in the amount of at least 5 million rubles.

Revisiting the first paragraph, it is worth remembering that the financial market is nothing but a system of relations between suppliers and buyers of financial services, which cannot fully exist without social capital (free funds of citizens). And a citizen, in turn, will go by the rule “cross the stream where it is shallowest”, i.e. without trust in the tools and services, the development which all await, will not happen.

Today, the Bank of Russia is not only interested in developing such trust, but also takes an active part in it (including the implementation of the Financial Literacy Program). The legislative framework discussed above is also evolving in order to support a trust-based relationship in the financial market. From the analysis of the Central Bank’s documents, we can highlight the following principal steps in this direction:

- Reduction of transaction costs incurred in the market aimed at protection against unfair conduct, the result of such actions will be a diminishing need for supervisory actions by the Bank of Russia;
- Protection of creditors’ and depositors' funds, which is possible only with strengthening credibility of national currency, payment systems and technologies in the market, as well as with improving financial stability of organizations;
- Combating fraud, setting up barriers for dishonest, illegal (unauthorized) activities. The result of such efforts should be elimination of advantages of such players over bona fide market participants, for this purpose elements of corporate culture are being introduced, where the priority is the interests of the client;
- Constituting of a transparent information system necessary for understanding the process of pricing and perception of the financial product.

All of the above measures are intended for encouraging and enhancing participation of population in utilizing financial market services.

The Bank of Russia takes a proactive position in protecting consumers from possible abuses by sellers of financial services. One of the key conditions for the successful development of banking activities is the policy of continuous innovation [16].

In 2017, the regulator, together with the financial market participants, developed the concept of the investor qualification system, however, today there are a lot of disputes and discussions around it. This concept is a part of the Law "On Securities Market" where regulation of categories of investors – individuals – is introduced. At the end of July 2020, the President of Russia signed the Law on Investor Categorization (Federal Law No. 306-FL of July 31, 2020 "On Amendments to the Federal Law on the Securities Market and Certain Legislative Acts of the Russian Federation").

In accordance with the latest developments, two investor categories have been specified. However, the testing mechanism for obtaining upgraded status has not been finalized.

IV. CONCLUSIONS

According to the law, individuals recognized as qualified investors until April 1, 2022 will retain their status in respect of securities and those financial instruments for which they were recognized as such.

The law also specifies the liability of brokers for selling to unqualified investors assets not corresponding to their
category. Illegal sale of such assets is brought to a minimum. The new law provides for the compensation of all expenses (commissions) to the investor and the redemption of the asset.

Non-qualified participants of the financial market are eligible to acquire:

- Moscow Exchange quotation list shares (first and second level issuers);
- ETF of Russian providers FinEx and INIFunds;
- Simple bonds of Russian companies;
- Federal loan bonds (OFZ) and municipal bonds;
- Units of stock exchange mutual funds from Russian providers (Alfa Capital - AKNX, Sberbank - SBSP);
- Certain Eurobonds of Russian companies (not subordinated);
- Currency;
- Reliable foreign bonds (including government bonds of the European Union and the UK, corporate bonds of companies established in these countries, if the performance of obligations under the bonds is provided by a legal entity registered in the Russian Federation and rated not lower than the Bank of Russia).

Unqualified investors have the right to participate in the IPO, including foreign companies, provided that the company is listed on the Moscow Exchange quotation lists.

In order for an unqualified investor to be able to acquire inaccessible for his category financial assets, it is necessary to pass testing on the instrument or investment method of interest or to obtain the status of qualified investor.

As for the testing, the new mechanism for the protection of unqualified investors will come into force from April 1, 2022. The standard test is expected to consist of two blocks. The first block will evaluate the investment experience, the second - the knowledge of a specific instrument. The procedure of testing and the list of questions will be approved by the regulator. According to the law, testing is free of charge.

Any financial market participant (bidder) that meets one of the requirements may become a qualified investor:

- Total value of assets (securities, units, deposits, cash in accounts, etc.) of the investor exceeds 6 million rubles (excluding real estate);
- The volume of transactions with securities during the year is above 6 million rubles (at least one transaction per month and at least 10 transactions per quarter);
- Profile work experience of over 2 years in an organization that participates in organized tenders;
- Higher education in economics from a specialized university that attests in the field of professional activity on the securities market;
- Completion of one of the following international qualification certifications:
  - CFA (Chartered Financial Analyst) professional examination in the field of financial asset management;
  - FRM (Financial Risk Manager) specialized certificate in the field of risk;
  - ACCA (Association of Chartered Certified Accountants) - a global community of professionals in accounting and management accounting, auditing, corporate finance. It is considered one of the most authoritative and prestigious in the world;
  - CIA (Certified Internal Auditor) document confirming the international qualification "Certified Internal Auditor", awarded by the Institute of Internal Auditors of the USA;
  - CIIA (Certified International Investment Analyst) - Certified International Investment Analyst is a well-known international professional qualification and certification program for those working in the field of finance and investment;
  - CIMA (Chartered Institute of Management Accountants) is an international association of management accounting professionals from the United Kingdom of Great Britain and Northern Ireland. It is relevant for CFOs, senior executives or managers of their own successful business.

  - Minimum 3 years of working experience in a financial organization (defined in paragraph 2, Article 51.2 of the Federal Law of 22.04.1995 № 39-FL "On Securities Market");
  - The total amount of assets exceeding 50 million rubles.

Professional investors have access to operations with any type of financial instruments.

The above discussed law is envisaged to balance the interests of the market with those of unqualified retail investors.

Also among the priorities of the regulator is the achievement of financial stability - "...smooth and efficient functioning of the financial market, including the process of transformation of savings into investments, its resistance to internal and external shocks" [15]. Therefore, financial stability will allow to reduce economic costs of financial risks. It will also increase the predictability of the capital value for economic entities, which in turn will ensure continuity of services and minimize possible structural imbalances. From the above, the key point for an investor (a citizen) will be the following: provided shock protection by the system itself will reduce the premium for the system risk, and the instrument will become more accessible for the consumer.

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