EUROMONEY

Russia crisis proves rewarding for nimble BCS

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Roman Lokhov has transformed BCS from a Russian retail broker to a full-service investment bank through a combination of technology, transparency and opportunism. Now he is looking to bring a new generation of Russian companies to the global markets.

Roman Lokhov, BCS

How do you build up a top-tier institutional markets business from scratch? That was the question facing Roman Lokhov in 2012 when he took over as chief executive of BCS. One of the oldest and best-known financial players in Russia, the firm was at the time still a purely domestic retail broker. Lokhov was hired to make it international.

The blond banker from Novosibirsk was a natural choice to lead the expansion. Educated in Germany and the US, he started his career as head of the Moscow office of financial software provider GL Trade (now part of SunGard) before taking over the securities arm of Russian private-sector bank Otkritie in 2007.

During his five years at Otkritie, Lokhov oversaw the creation of a full-service investment bank, including, among other things, the opening of offices in Frankfurt, London and New York, and the launch in 2010 of the first trading platform to offer direct market access (DMA) to Russia for international equity investors.

The experience stood him in good stead at BCS. Again, one of his first moves was to set up a London office – near the top of Tower 42, with dazzling views down the river. This time, however, he went straight after the high-tech trading market. “We targeted algo funds, high-frequency traders, everything that was based on tech,” says Lokhov.

As he explains, this was partly because BCS had the expertise in-house to do so (Lokhov took more than 100 people with him went he left Otkritie, including IT staff as well as bankers) and partly because it was the quickest way to win international clients.

“It’s something you can build up more quickly because it’s not about trust, it’s about the platform,” he says. “If you have a better product, you will win business.”

Long term

The combination of a best-in-class DMA platform with BCS's unrivalled domestic retail base – the firm has 160 offices across Russia – proved a hit with prime brokerage clients. Within two years, BCS had boosted its share of trading on the newly rebranded Moscow Exchange to close to 25% across all asset classes. Meanwhile, Lokhov was also working on the more protracted process of creating a capital markets business.

"That takes more time," he says. "You have to build up research and trading, you have to talk to the buy side. Everyone has to see that you are there for the long term and what your ideas are, where you can add value."To add to the challenge, from mid-2014, BCS's fledgling international business was operating against a backdrop of turmoil in its home market, as Russia was hit first by western sanctions and then by the collapse of the oil price.

Lokhov says sanctions – which barred state-controlled energy firms and banks, including VTB and Sberbank, from raising international long-term funding – were not a particular concern for BCS. He puts them in the same category as the merger of the Bank of England and Financial Conduct Authority, which delayed the arrival of the firm's UK licence, and the Cyprus crisis, which affected the subsidiary it had set up there as a work-around during the delays in London.

"These are just black swans," he says. "Something like that happens every year. Sanctions were a disadvantage in that we had fewer instruments to trade. On the plus side, however, we got more clients, because our major competitors in several segments were state banks."

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The oil price fall in September 2014 and subsequent rouble collapse were a more serious test of BCS's new systems and platforms, but again the firm came through with flying colours, posting healthy profits as many of its Russian peers slid into the red. This was partly due to BCS's unique client base. As Lokhov notes, domestic retail customers proved relatively immune to market shocks.

"This is not an institutional investor base that pulls out at the first sign of trouble – 160,000 customers won't all start panicking," he says. Meanwhile, BCS's high-tech and prime brokerage client base thrived on the upheavals. "These guys love volatility, they sit and dream all day that something like this happens," says Lokhov. "The HFTs, the algo guys, the hedgies, the arbitrageurs – they all piled into Russia. It was crazy." At one point, BCS accounted for more than a third of turnover on the Russian market as daily trading volumes on its DMA platform jumped from 700,000 to close to 3 million.

"Of course we did see money going out," adds Lokhov. "Long-term investors hate uncertainty, institutional investors were scared of the rouble, certain banks started to close lines. But everyone who likes volatility increased their business."BCS was also less affected by the subsequent economic recession in Russia than domestic rivals such as Sberbank, VTB and Otkritie, thanks to its limited balance sheet exposure.

"When you are a big commercial bank, you suffer when the economy does," says Lokhov. "We've never had that, so we could invest aggressively at a time when everyone else was pulling back."There were certainly plenty of opportunities to do so. As economic stagnation set in, western banks slashed headcount in Moscow and reduced their Russia coverage. As a result, many were on the hunt for a local partner – with VTB and Sberbank under sanctions, BCS was the natural choice.

"Every time a large global bank reduced its desk in Russia, my London office got a new client," says Lokhov. "We positioned ourselves as a door to Russia." At the same time, Russian banks were pulling back from the west. Sberbank pared its overseas operations to the bone, while VTB Capital also cut staff in London and New York. Even private-sector players such as Otkritie and Aton Capital lost their appetite for international expansion and refocused on their home market.

Again BCS bucked the trend, moving into the US just as its Russian rivals were fleeing the market. In late 2015, the firm announced plans to buy New York-based brokerage Alforma Capital Markets from Alfa-Bank, the lender owned by Russian billionaire Mikhail Fridman. The acquisition was approved by US regulators in June last year.

This is a bold move given that Russian players have traditionally struggled to gain traction in the US. Why does Lokhov believe BCS can succeed where others have failed? "We are flexible and tech-intensive, but more importantly we have a full-service offering in terms of platforms, financing etc.," he says. "I think the mistake Russian banks have made in the past is that they went to the US with just one service – sales trading and research for Russian assets."

European assets

In an even bolder move, Lokhov is now looking to expand BCS's offering to include European assets as well as Russian. He is particularly targeting hedge funds left without prime brokerage services as big European banks, under regulatory pressure, have cut their client lists. "These banks want to earn at least $500,000 a year from a hedge fund or they won't service them," he says. "We have the partners, we have the tech, we have the infrastructure and we have excellent capital adequacy, so we are well-placed to go after these customers."

BCS is developing a platform in London to serve this "mini prime" segment and is looking to roll it out in the US in due course. "This is in line with our overall strategy," says Lokhov. "We are always looking to identify a niche where we can be number one."He believes he has spotted a similar gap in BCS's home market, namely in investment banking. With global banks on the retreat from Russia over the past three years, VTB Capital and Sberbank CIB have been kept busy servicing the country's largest corporates. As a result, says Lokhov, a large section of the Russian market has been left without investment banking coverage.

"Mid-caps in Russia are underbanked," he says. "They need investment banking services but the state banks and bulge-bracket players don't have time to cover them or don't want to work for the fees on offer." Lokhov is looking to fill that vacuum. BCS began building up an investment banking team last year, hiring aggressively across debt and equity capital markets, as well as advisory. Again, downsizing at both international and Russian state banks worked to the firm's advantage, this time by providing a deep pool of banking talent to draw on.

Yuri Prilipov, BCS's head of investment banking, was one of dozens of senior bankers left stranded by Sberbank CIB's pullback from the segment, while other recent hires were formerly leading lights in the Russia operations of Barclays, Deutsche Bank, UBS and Credit Suisse. BCS has already notched up several successes in ECM, most notably winning a mandate on the R32.4 billion ($502 million) Moscow IPO of private-sector oil firm Russneft in November. This year, however, the firm's focus has shifted to fixed income as demand for Russian corporate bonds has soared among both domestic and international investors.

In Russia, retail clients are finally joining the international hunt for yield as domestic interest rates continue to fall – a process that is being actively encouraged by local policymakers. In a bid to boost the development of local debt markets, the Russian central bank recently adopted a strategy it calls "bondinization".

This has already produced results. In January, taxes on coupon payments were eliminated for retail investors.

"It's going to be a huge move," says Lokhov. "All the retail money in Russia traditionally went into bank deposits because they were tax-free. Now they can buy bonds." With its unrivalled retail distribution, BCS is ideally placed to take advantage of this shift – particularly after a recent joint venture with leading Russian consumer finance player Tinkoff Bank. Launched in October, the partnership involves BCS offering brokerage services through Tinkoff's successful 'financial marketplace' online platform.

Lokhov says the tie-up was a natural fit, given both firms' focus on technology. He also notes that the two companies share a Siberian heritage. BCS was founded in Novosibirsk in 1995 by Oleg Mikhasenko, who remains sole owner and president of the group, while Tinkoff's founder, the famously flamboyant Oleg Tinkov, hails from a small town in nearby Kemerovo.

The partnership is already proving extremely lucrative for BCS. "In the first month of operation, before marketing had even started, we acquired as many new accounts as we would normally expect in a year," says Lokhov. At current growth rates, he adds, BCS's retail client base will expand by around 100,000 this year, an increase of nearly two thirds from 2016.

Meanwhile, the firm's institutional client base is also regaining its appetite for Russian assets following the country's emergence from recession in the first quarter. International investors have even shown a willingness to look at rouble assets again, as evidenced by strong foreign flows into Russian domestic government bonds this year.

"Investors feel that the rouble is back to being a stable currency," says Lokhov. "Plus, rates are so low that a lot of funds don't care about the currency if they can get yield. And the option to swap into dollars is still there, so the carry trade still works." Foreign funds might nonetheless be expected to be nervous of rouble-denominated corporate bonds, especially from the mid-cap firms that BCS is targeting. Lokhov says that is precisely where the firm can add value, by bringing transparency to a traditionally opaque sector.

"A key tenet of our strategy is to position ourselves as an open, western-minded firm – to offer Russian products to investors as if Russia was a fully developed market, not an emerging market," he says. "We would never sell our investors something that isn't transparent because it's not in our culture."

For Russian corporate bonds, this means ensuring that all issues are exchange-listed (and if possible Euroclearable), come with a detailed prospectus and are supported by BCS's highly rated research team. Lokhov also believes BCS's local expertise will enable the firm to identify potential borrowers that are stronger than implied by their single-B ratings, particularly in Russia's regions.

"We look for companies that have survived two crises – in 2008 and 2014 – and are the sole business of their shareholder, for example," he says. "I am confident we can find 200 to 300 good firms that need financing and are ready to place bonds."

Marketing such issues to international investors would be an innovation, but one that Lokhov says has been made possible by a combination of dramatic improvements to Russia's capital markets infrastructure over the past six years and a related shift in attitudes on the buy side.

"Five years ago, if a Russian company wanted to do a $30 million bond, international investors wouldn't have been interested," he says. "Now the deal size has gone down. Investors are looking for opportunities, and they will invest in assets that might be less liquid if they like the company."

BCS is also looking to capitalize on this trend by bringing Russian mid-caps to the equity markets. Early this year, the bank began taking a selection of Russian companies from sectors as diverse as IT, retail and construction to Scandinavia to discuss IPO plans with the region's Russia-focused funds. In May, six of these rising stars also met BCS's international clients in London.

The bank also takes an active role in educating Russian firms on how to appeal to global investors – a process that Lokhov says has become much easier since 2014. "Traditionally, most Russian companies have only understood bank credit," he says. "After the recent crisis, they started to realize that if they want to raise funding, they need to be more flexible."

Strong brand

He notes that BCS's strong brand helps it to gain traction with Russian entrepreneurs, particularly in the regions ("We are much better known in Siberia than JPMorgan!"), while being able to offer the services of top-tier investment bankers is also a key selling point. "If you go to a mid-cap in Russia with the sort of expertise that we have in our team, they belong to you because no one has ever tried to approach them before," says Lokhov. "This is the first time they see that someone is interested in them and appreciates what they are doing."

He is confident that this approach will benefit both BCS and the wider Russian economy. "There is a new generation of management in Russia and hundreds of good smaller companies," he says. "If we can bring them to international investors, it will make them stronger, it will make Russian capital markets stronger and it will help the integration of Russia into the global financial system.

"And it will be good for us in the long run because mid-cap companies become larger companies – and if you treat people fairly they remember it."

Lokhov is well aware, however, that BCS's competitive advantage in this and other target segments will not remain unchallenged. "At the moment, we have several niches more or less to ourselves as internationals and Russian banks refocus – but that won't last for ever," he says. "Competition will come back, which is why we have to be as quick as possible to grab market share now."