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Raising The Ruble

Despite the considerable pain inflicted by the financial crisis, the Russian market continues to hold promise for international investment firms. By *Joel Clark*

When severe volatility forced trading to grind to a halt on Russia's two leading stock exchanges in mid-September 2008, it was clear that the global financial crisis, from which Russia had so far been cushioned, had finally hit the market. The exchanges, Russian Trading System (RTS) Stock Exchange and the Moscow Interbank Currency Exchange (Micex), were closed repeatedly in the weeks that followed-sometimes for the entire trading day-and the value of Russian stocks plummeted. Coming at the end of a period of sustained growth, the downturn has hit the Russian market badly and considerably dampened international interest in investing in Russia and trading its stocks.

Despite the downturn, many believe that, in time, Russia will emerge and continue its growth curve. Interest may have declined, but brokers and vendors continue to promote the market internationally and some are still advancing with their plans to enter the market. Adrian Braun, head of middle office and electronic connectivity at German brokerage Steubing AG, is readying his firm to carry out its first test trades in Russia by the end of this month. "Russia is a huge and unexploited market, with big companies listed there and high margins," he says. "There is demand from our institutional clients and it offers competitive advantage for us." The Frankfurt-based firm trades on more than 30 international markets and, although the financial crisis delayed its original plans to enter the Russian market in the fourth quarter of 2008, Braun is certain that it will be there soon.

Steady Growth

In the decade leading up to 2008, the Russian financial market grew steadily and began to mature into a truly international market that might eventually compete with the world's major financial centers. Top-tier investment banks saw the value of diversifying into Russian stocks and domestic Russian institutions also looked to broaden their own activities by investing and trading internationally. As Alfa Bank analysts Angelika Henkel and Vladimir Dorogov note on page s10 of this special report, Russian companies attracted roughly \$71 billion on the international markets in the first half of 2008 and the benchmark RTS Index reached its record level of 2,488 points in May. As oil prices soared to all-time highs in the early months of 2008 and investors sought a safe haven from the financial crisis that had already permeated much of Europe and the US, Russia seemed a very strong prospect.

Several major software vendors operating in Europe and the US were quick to take advantage of the growth, tapping the demand for trading technology at Russian investment firms and the desire of top-tier banks to trade Russian stocks. "Russia is often treated as an emerging market but it's actually a lot more sophisticated than people give it credit for," says Clive Pedder, CEO for the Europe, the Middle East and Africa in the global trading arm of SunGard, formerly known as GL Trade. GL Trade has had an active presence in Russia for at least four years and now has a local office in Moscow. It has been supporting roughly 20 Russian sell-side banks, which use its trading technology to access the markets. "Certainly the Russian market has had a tough time in the past few months, but a great number of the firms operating in that market are highly sophisticated; some are tier-one international players," says Pedder.

GL Trade is by no means the only large software vendor to have seriously targeted Russia in recent years. Orc Software, a Stockholm-based provider of trading technology, boasts a strong Russian client base, with offices in both Moscow and St Petersburg, and London-based vendor Fidessa has also focused heavily on Russia over the past 18 months.

"We saw huge demand in Russia for the import and export of liquidity," says Steve Grob, Fidessa's director of strategy. "We found that a lot of our large international banking customers were active in the region and wanted to take their Fidessa platforms into Russia. There was also huge latent demand within the domestic Russian trading community to trade internationally." Fidessa's ability to connect clients to exchanges in international markets like London and Frankfurt is certainly an appealing proposition for Moscow-based firms formerly restricted to trading only Russian stocks.

For all the activity of international vendors, Russia is certainly not bereft of its own technology strengths. Arqa Technologies, a local company based in Novosibirsk, the country's third-largest city, also offers platforms for the automation of brokerage and banking through its QUIK Brokerage System and QORT, a platform for the development of middle- and back-office systems. "I don't think technology is a limiting factor to the Russian firms," says SunGard's Pedder. "When we deal with CIOs and technical teams within our Russian customer base, we see them as no different to the teams we deal with in more developed markets and we deploy technology at exactly the same level of sophistication."

In fact it is by partnering with Arqa Technologies and its QUIK product that both Fidessa and GL Trade have been able to adapt their systems for the Russian market. "Arqa is a very significant local provider," says Dan Smalley, head of business development in Fidessa's enterprise division. "They see us as their partner in being able to provide international market access and we see them as a very useful partner in terms of giving us access to the Russian market."

Exchanges call time

By the end of Q3 last year, international enthusiasm about the prospects for Russia had certainly dampened as the collapse of Lehman Brothers and the troubles of other major financial institutions created a heavy storm that flowed quickly eastwards. Russia's top regulatory body, the Federal Financial Markets Service (FFMS), rules that when its main technical index fluctuates by a certain percentage, trading must be suspended on all exchanges to ensure an orderly market. So it was that on Tuesday, September 16, 2008, when the index fell by more than 8 percent, trading was suspended on both RTS and Micex. For the remainder of that week and over the month that followed, trading was repeatedly interrupted in line with the regulations, damaging the market's reputation considerably.

Roman Goryunov, CEO of RTS, believes that, although the regular halts to trading last year were disruptive, they were effective in guiding the market and the exchange through an exceptionally challenging time. "The idea is to calm down the investors and to curb bank sell-outs driven by stricken investors," he explains. "In spite of the extraordinarily high volatility in the market, RTS has managed to guarantee settlement of all the trades that were executed on our markets."

But while Goryunov may support the FFMS regulation, it did not stop the sharp fall in prices and the exit of a large number of investors from the market. For firms outside Russia, the unavailability of the stock exchanges on a number of days last year is a very serious issue and has made it far more difficult to justify Russian activity to the end investor. "As soon as there is a problem in Russia, the market just closes down and that's certainly not something that increases confidence," says Steubing's Braun.

Russian institutions are not blind to the effect that the interruptions have had on the market's reputation and Goryunov suggests that the FFMS might expand the limits for the movement of the technical index. Fidessa's Grob believes such a move would be a big advantage. "They probably do need a more sophisticated approach because, when the government effectively shuts them down, the exchanges dent their credibility and that has led some international investors to be less interested in trading into Russia," he explains.

Reversal of fortunes

Although the outages at the Russian exchanges and the overall economic climate have had an adverse effect on external interest in Russia, the possible silver lining is that domestic Russian firms have become more interested in trading internationally—a trend seen by numerous brokers and vendors. "We've always seen both sides, but since the credit crunch the scales have tipped in favor of brokers looking outwards rather than international players looking inwards," says SunGard's Pedder. Fidessa's Grob agrees: "For Russian traders wanting to find more places for their money, we've only seen that increase and we're seeing more and more flow come across our network from Russia into the broader global markets."

The increasing flow of liquidity between Russia and the rest of the world has driven the Russian exchanges to consider the best ways to compete with international peers like the London Stock Exchange, the New York Stock Exchange and Nasdaq. At present the regulatory framework means that Russian exchanges cannot allow remote membership to brokers not established and regulated within the country. Although it would be up to the government and regulators to remove that barrier and allow remote access, RTS is taking its own steps to compete internationally. Late last year it introduced an additional evening trading session to coincide with trading in the US and is looking at extending further to level with other international time zones. "The evening trading session allows our investors to trade in the US when the main trading session on the Russian market has closed and it also allows US investors to trade Russian stocks more easily," says Goryunov.

RTS and Micex are both well aware of the need to attract non-Russian firms into the market, but the ban on remote access is a serious stumbling block, as few brokers would be willing to invest the resources and money needed to set up a local presence. When it makes its first trades on the Russian market in the next few weeks, Steubing will sidestep the barrier by going through an introducing broker, Otkritie Securities. A subsidiary of Russian investment bank Otkritie Financial Corporation, Otkritie Securities is based in London and provides a gateway to the Russian market for those international brokers that seek access but prefer to avoid all the resources needed to connect themselves.

"As the financial situation stabilizes, we believe that Russia will move onto a level playing field with the rest of Europe over the next three years," says Roman Lokhov, CEO of Otkritie Securities. With offices in London and Frankfurt, Otkritie's mission is to promote the value of Russia and ease the heavy burden of connectivity. Lokhov also reveals that the company is planning to expand its presence into New York and Hong Kong, helping to expand Russia's reach.

Strong prospects

Despite the serious challenges that have faced Russia in the past six months, it is clear that the market continues to hold a great deal of promise. International interest in Russian stocks has naturally diminished since the onset of the economic downturn but those active in the market are adamant that it will pick up again in time. One day, they believe, Moscow may even come to be uttered in the same breath as London, New York and Hong Kong.