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Research Update:

Russian BCS Holding International Ltd. Assigned 'B-/C' Ratings; Outlook Stable

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Overview

- We have assessed Russian BCS Holding International Ltd. (BCS Holding) under our criteria for rating nonoperating holding companies and based on the stand-alone creditworthiness of the consolidated operating BCS Group, to which we assign a notional group credit profile (GCP) of 'b'.
- We are therefore assigning 'B-/C' long- and short-term counterparty credit ratings to BCS Holding.
- The stable outlook reflects our expectations that BCS Holding will generate positive income from its core retail brokerage business and will increase its profits from institutional brokerage over the medium term.

Rating Action

On Oct. 29, 2012, Standard & Poor's Ratings Services assigned its 'B-/C' long- and short-term counterparty credit ratings to Russian BCS Holding International Limited (BCS Holding). The outlook is stable.

Rationale

The ratings on BCS Holding reflect our assessment of the creditworthiness of the wider BCS Financial Group (BCS Group) and its status as a nonoperating holding company (NOHC) within the group. BCS Holding, registered in the British Virgin Islands (BVI), is the 100% owner of several companies that form BCS Financial Group.

According to our criteria, we typically view the creditworthiness of an NOHC as marginally weaker than that of its operating companies. We assign a notional group credit profile (GCP) of 'b' to BCS Group and rate BCS Holding one notch below. Our assessment of the group's GCP is constrained by our view of the vulnerability of its earnings to a potential decline in trading volumes, its confidence-sensitive funding base, its complex--although typical for the industry--group structure, and its fragmented regulatory supervision.

These factors are partly mitigated by the company's well-established franchise in retail brokerage in Russia, an experienced and innovative management team, and our assessment of adequate capitalization for the current ratings. We do not factor any extraordinary parental support into our assessment of BCS Group's GCP, as we consider this support to be uncertain. BCS Group's president, Oleg Mikhasenko, is the founder and the sole owner of the group.

Founded in 1995, BCS Group is one of the largest Russian retail brokers with more than 100,000 clients. We understand that the group has a leading position on the Moscow Interbank Currency Exchange. In September 2012, BCS Group's equity trade turnovers were among the highest for retail brokers in Russia, turning over Russian ruble (RUB) 192 billion for the month. Its overall trading volume was RUB3.4 trillion in 2011. BCS Group had RUB49 billion ($1.5 billion) of assets and RUB9.4 billion ($286 million) of capital at mid-year 2012.

BCS Group has a complex international group structure, comprising a number of entities in Russia and abroad, most of which carry the BCS brand name. BCS Group's main operating companies in Russia are BrokerCreditService LTD, OOO Investment Management Company Brokercreditservice, and JSC "BCS – Investment Bank". BCS Group currently carries out operations with international investors through BCS (Cyprus) Ltd., but plans to transfer those to U.K.-based BCS Prime Brokerage Ltd., which was established in April 2012.

Until 2008, BCS Group was a pure retail broker, but, after the financial crisis, reconsidered its strategy and moved from being the monoline provider of retail brokerage for middle-class clients toward becoming a financial company with a full range of investment and advisory products, suitable for existing retail customers, high-net-worth individuals, and institutional clients. As of year-end 2011, retail brokerage accounted for 64% of total operating revenues of RUB4.7 billion, institutional brokerage made up 28% of revenues, and the rest was primarily rental income. We expect the share of revenues from institutional brokerage to increase to half of the group's total revenues in the next two to three years.

BCS Group's risk profile is dominated by market and liquidity risks, followed by credit risks, and high operational risks, exacerbated by the unstable operating environment.

Counterparty risk mainly comes from the group's repurchase agreements (repos), margin lending operations, and cash placements. Brokerage transactions are settled on a DVP (delivery versus payment) basis, which we believe somewhat reduces the company's settlement credit risk. BCS is heavily involved in margin lending to its clients, accounting for 11% of BCS Group's assets (55% of equity) at mid-year 2012. Margin lending terms are in line with the industry average, with maximum leverage of one to three. Counterparty single-name concentrations are moderate: the top-20 repo counterparties accounted for 37% of total receivables at mid-year 2012.

In addition to margin lending, BCS Group provides repo loans to its own counterparties, which made up a sizable 23% of its own assets at June 30, 2012. BCS Group applies fairly conservative haircuts on repo and margin loans, mitigating potential credit and market losses. Moreover, haircuts on most of its repo borrowings are generally lower than for its repo lending, which, to a certain extent, protects the company from adverse market developments.

BCS Group's exposure to market risk stems from the above-mentioned margin lending activities and proprietary securities portfolio of RUB14 billion as of June 30, 2012. This portfolio comprises 28% of BCS Group's assets and 148% of its equity as of the same date. We understand that the group follows a conservative trading strategy, focusing on fairly liquid bonds rated 'B-' or above. Long equity positions accounted for 21% of the total portfolio at mid-year 2012. Single-name issuer concentrations are high, reflecting the limited number of available investments on the market, which in our view may suit the group's limited risk appetite.

The structure of BCS Group's short-term funding reflects the short-term maturity profile of its assets. Customer brokerage accounts made up 38% of total liabilities at mid-year 2012. BCS Group uses these on-demand resources for overnight margin lending. We deem customer accounts to be volatile and moderately concentrated, with the top-20 customers accounting for 26% of total brokerage accounts as of June 30, 2012. At the same date, repo borrowings and customer deposits in the BCS subsidiary bank (JSC "BCS – Investment Bank") funded 21% and 15% of total liabilities, respectively. Another 20% of liabilities were represented by financial instruments at fair value through profit or loss, which is mostly short position in equities. These short equity positions are hedged by long futures positions so that the group captures the interest rate differential between the interest rate implied in the equities' futures contracts and the repo rate. We believe, however, that these strategies could potentially make the group vulnerable to a sharp drop in the value of stock prices as it would have to post additional margins on its long futures position (thus putting pressure on liquidity).

In our view, BCS Group's profitability largely depends on the performance of the Russian stock market. In the autumn of 2008, the company's monthly trading volumes declined by half, thus putting pressure on the group's bottom line results. At the same time, we note that the diversification of BCS Group's customer base provides some protection from adverse market developments (the top-20 retail clients accounted for 7% of operating revenues as of June 30, 2012.)

With total equity of RUB9.4 billion and adjusted total equity to adjusted assets of 18% on June 30, 2012, BCS Group has a good cushion to absorb further potential market or credit losses, in our view. The quality of capital is relatively good because it only comprises Tier 1 capital. Moreover, there is no debt at the holding company level.

Outlook

The stable outlook reflects our expectations that BCS Group will conclude the streamlining of its business and the start-up of its new business lines within the next 12 months, in line with its new strategy. The outlook also reflects our belief that the group will generate positive income from its core retail brokerage business, and will increase its profits from institutional brokerage over the medium term.

We could raise the ratings on BCS Holding if we see improvements in the group's business line diversification, higher operating efficiency, and the group's ability to sustain operating performance throughout market cycles. We could lower the ratings, however, if the company's liquidity or capital positions were to weaken significantly or if the company exhibits a higher proprietary risk appetite. Substantial counterparty confidence disruption, or another prolonged market downturn, could also lead to negative rating action.

Conversely, the sustainable improvement in the Russian operating environment could potentially result in positive rating action, provided that the group keeps its risk appetite under control.

Related Criteria And Research

- Analytical Approach To Assessing Nonoperating Holding Companies, March 17, 2009
- Broker-Dealers: Rating Securities Companies, June 9, 2004
- Group Rating Methodology And Assumptions, Nov. 9, 2011

Ratings List

New Rating; CreditWatch/Outlook Action

BCS Holding International Ltd.	
Counterparty Credit Rating	B-/Stable/C

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