

Research Update:

FG BCS Ltd. And Its Rated Subsidiaries Outlooks Revised To Stable From Positive On Market Conditions; Ratings Affirmed

April 14, 2020

Overview

- We believe that substantial global capital market turbulence since March, the world COVID-19 pandemic, and lower oil prices are likely to negatively affect FG BCS Ltd.'s revenue and risk-adjusted capital (RAC) in 2020.
- As a result, we are revising the outlook on FG BCS and its operating subsidiaries BrokerCreditService (Cyprus) Ltd., BrokerCreditService Structured Products PLC, and BCS Prime Brokerage Ltd., to stable from positive.
- We are also affirming our 'B/B' long- and short-term issuer credit ratings on FG BCS and 'B+/B' ratings on the operating subsidiaries.
- The stable outlook reflects our expectation that unfavorable market and economic conditions in 2020 will likely affect the company's profitability, but we expect strong but declining RAC and adequate liquidity to withstand potential stresses.

Rating Action

On April 14, 2020, S&P Global Ratings revised its outlook on FG BCS Ltd. and its operating subsidiaries BrokerCreditService (Cyprus) Ltd., BrokerCreditService Structured Products PLC, and BCS Prime Brokerage Ltd. (BCS Prime) to stable from positive. We also affirmed our 'B/B' long- and short-term issuer credit rating on FG BCS and 'B+/B' long- and short-term issuer credit ratings on its operating subsidiaries.

Rationale

The outlook revision reflects our view that the global capital markets downturn and sharply increased volatility and weaker macroeconomic conditions in Russia and worldwide due to the COVID-19 pandemic and decline in oil prices are likely to negatively affect FG BCS's and its

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subsidiaries' profitability and risk-adjusted capital (RAC) this year.

FG BCS is one of the largest and most diversified brokers in the Russian market. It serves 10%-15% of domestic retail brokerage clients and is the largest operator in the equities and derivative market on the Moscow Exchange, with 20%-25% market share throughout 2019.

We expect that our forecast of a 0.8% GDP contraction in Russia in 2020, which could potentially be revised down, will have negative effects on the revenue and growth prospects of BCS Global Markets' Investment Banking division (about one-third of 2018-2019 group revenue). In our view, underwriting, initial public offering, and merger and acquisition deals will slow down this year so long as high uncertainty related to COVID-19 remains.

However, revenue in the retail segment for fee-based brokerage and asset management is likely to increase because of an influx of new retail clients and expanding client balances following the recent introduction of a tax on deposits interest, drop in equity prices and increased volatility in capital markets (since mid-Feb. 2020). The retail segment accounted for about one-third of revenue in 2018-2019.

Furthermore, the group expects growth to continue this year in structured products sold to high net worth individuals and retail investors, which accounted for about one-third of 2019 revenue. We see a risk, amid declining capital markets, of a potential rise in miss-selling claims. Moreover, stock market declines may also expose the firm to margin calls on structured product hedges in the form of derivative contracts with market counterparties. This would strain liquidity at a time it is most needed and potentially also expose the company to trading losses (including foreign-exchange risk) if some hedges prove inefficient. Historically, FG BCS hedged through trading assets with underlying sold structured products.

Since the beginning of 2020, FG BCS has been gradually reducing its trading positions. Its trading bond portfolio was about Russian ruble (RUB) 20 billion and equities about \$1 million at March 31, 2020.

We anticipate that our RAC ratio is likely to substantially decline in 2020 due to higher risk charges in light of increased capital market volatility and lower retained earnings. Nevertheless, we expect RAC to stay above 10% by year-end 2020, compared with 14.8% at year-end 2018.

We expect the group to maintain adequate liquidity and stable funding to withstand difficult conditions and potential increases in margin calls (notably in its structured products segment) and losses of clients' confidence-sensitive deposits at U.K. subsidiary BCS Prime. To cope with these risks, the group had about RUB162 billion in unencumbered liquid assets as of April 1, 2020, which is over 40% of its balance sheet.

In addition, FG BCS has access to the Russian central bank's repurchase agreement (repo) mechanisms via its banking subsidiary. We also note that the repo and reverse-repo transactions are generally matched in tenor, and there are no material mismatches between group entities. In addition, FG BCS benefits from more stable and diversified retail customer accounts than domestic peers; its large portion of repo liabilities that are created self-funded assets; and high quality of collateral.

Our stand-alone credit profile (SACP) assessment for BCS Prime is 'b' reflecting its limited size, concentrated clientele, and focus on prime brokerage services for institutional clients and professional investors. We assess the company's capital and risk position as adequate for the risks it faces. We view the company's funding as moderate reflecting its confidence-sensitive nature and elevated funding and liquidity risks in the prime brokerage business in current market conditions. We view BCS Prime as a core subsidiary of FG BCS and believe that it would benefit from group's support under most foreseeable circumstances

Outlook

The stable outlook on FG BCS and its core subsidiaries reflects our expectation that unfavorable market and economic conditions will likely negatively affect profitability, but that the company will operate with sufficient but declining capital and adequate liquidity to withstand potential stresses over the next 12 months.

Downside scenario

Over the same time horizon, a negative rating action could follow if we see higher pressure on FG BCS's RAC ratio and/or liquidity, and if there are additional operational and execution risks arising from the new organizational structure.

Upside scenario

An upgrade is unlikely over the next 12 months. However, over the longer term, a positive rating action could follow if we view FG BCS as a clear outperformer in 2020 among rated Russian securities companies, demonstrated by more sustained and less volatile performance, higher capital buffers, and adequate liquidity.

Ratings Score Snapshot

FG BCS Ltd.

	To	From
Issuer Credit Ratings	B/Stable/B	B/Positive/B
Group credit profile	b+	b+
Anchor	b	b
Business Position	Strong (+1)	Strong (+1)
Capital & Earnings	Strong (+1)	Strong (+1)
Risk Position	(Moderate (-1))	(Moderate (-1))
Funding and Liquidity	Average and Adequate-High (0)	Average and Adequate-High (0)
Comparable Rating Analysis	0	0
Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Holding Co. Notching	(-1)	(-1)
Additional Factors	0	0

BCS Prime Brokerage Ltd.

	To	From
Issuer Credit Ratings	B+/Stable/B	B+/Positive/B
SACP	b	b+
Anchor	bb	bb
Business Position	Weak (-2)	Weak (-2)
Capital & Earnings	Strong (+1)	Adequate (0)
Risk Position	Moderate (-1)	Adequate (0)
Funding and Liquidity	Moderate and Adequate-High (-1)	Adequate and Adequate-High (0)
Comparable Rating Analysis	0	0
Support	+1	0
GRE Support	0	0
Group Support	+1	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
FG BCS Ltd		
Issuer Credit Rating	B/Stable/B	B/Positive/B
BCS Prime Brokerage Ltd.		
BrokerCreditService Structured Products PLC		
BrokerCreditService (Cyprus) Ltd.		
Issuer Credit Rating	B+/Stable/B	B+/Positive/B

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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