

Research

Research Update:

Outlook On Russian Broker FG BCS And Subsidiaries Revised To Positive On Stronger Capitalization; Ratings Affirmed

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Overview

- FG BCS has been gradually diversifying away from its Russia-focused operations and developing its risk management framework to manage the increasing complexity of its operations.
- The group has also demonstrated a track record of sustainable earnings generation capacity, which has helped it to enhance its capital buffers.
- We are therefore revising the outlook on FG BCS Ltd. and its subsidiaries to positive from stable. We affirmed the ratings on FG BCS Ltd. at 'B-/B' and the ratings on its subsidiaries at 'B+/B'.
- The positive outlook reflects our expectation that over the next 12-18 months FG BCS will be able to manage the risks associated with the volatile geopolitical environment and increasing complexity of its operations, successfully transform its business, and increase its geographical diversification.

Rating Action

On Nov. 22, 2018, S&P Global Ratings revised to positive from stable its outlook on FG BCS Ltd. and its subsidiaries BrokerCreditService (Cyprus) Ltd., BrokerCreditService Structured Products PLC, and BCS Prime Brokerage Ltd. We affirmed the long- and short-term ratings on FG BCS Ltd. at 'B-/B' and the ratings on the operating subsidiaries at 'B+/B'.

Rationale

The outlook revision reflects our view of BCS' improved diversification and capital position, and our belief that the company will be able to manage the risks associated with its increased operational complexity and rapid expansion. FG BCS has gradually become a more diversified group on the back of its development of prime brokerage activities via its U.K.-based subsidiary and expanding access to the U.S. market. We think that these initiatives may reduce BCS' exposure to Russian country risk, which we consider to be positive from a credit perspective.

We have changed our approach for calculating FG BCS' capitalization. We now use a regular value-at-risk (VaR) metric rather than liquidity-adjusted VaR to

achieve better comparability with global peers. On a consolidated basis, we expect FG BCS' risk-adjusted capital ratio to stay at 13%-15% going forward, which is higher than our previous base-case expectation of 9%-10%. In our view, this supports a strong assessment of the group's capitalization, alongside strong earnings that consistently exceed 200% of our risk-weighted assets. This has helped the group to achieve a return on equity of 24.5% on average between 2014 and the first half of 2018.

At the same time, we note that the group aims to expand or reshape its operations in various business lines. Notable initiatives include:

- BCS Prime Brokerage Ltd.'s application for a proprietary license, which will lead to increased regulatory scrutiny.
- The issuance of structured products will be more reliant on derivatives to manage risks on the balance sheet of BCS. This is likely to require less wholesale funding, improving BCS' liquidity position.
- The group's intention to clearly separate its retail and investment banking arms, resulting in an increased number of regulated entities.

We have therefore revised BCS' risk position assessment to moderate from adequate. This reflects the fact that our capital model does not capture the additional price risk associated with the low liquidity of the markets BCS is exposed to (Russia in particular). The change also reflects the complexity associated with BCS' new initiatives, as well its historically aggressive growth, as evidenced by the expansion of the group's balance sheet by 27.5% per year on average between 2014 and the first half of 2018 even though this has somewhat slowed down over the past year.

BCS has historically been fairly successful in managing complexity risk and rapid geographic expansion, however. Its cost of risk has been contained and its performance has generally been good, as backtesting has witnessed a number of VaR breaches in line with model parameters.

We continue rating FG BCS Ltd. two notches lower than the group credit profile. This reflects the structural subordination of the holding company's liabilities relative to liabilities of operational entities.

Outlook

The positive outlook on the ratings on FG BCS Ltd. and its core subsidiaries BrokerCreditService (Cyprus) Ltd., BrokerCreditService Structured Products PLC, and BCS Prime Brokerage Ltd. reflects our view that we could raise the ratings in the next 12-18 months if the group demonstrated the ability to operate effectively and manage all the risks associated with the increasing complexity of its operations, while maintaining a sufficient capital buffer.

We are likely to raise the ratings if we see the BCS group maintaining strong

capitalization while adequately managing risks associated with its growth, changes in corporate structure, and hedging strategy. We could also consider raising the ratings if the BCS group achieves stronger geographical diversification, which may come from its expanding prime brokerage activities.

We may revise the outlook to stable if, contrary to our expectations, the group's RAC ratio decreased to below 10% and earnings declined to a level we no longer considered strong. We may also revise the outlook to stable if we see group's risk profile deteriorating.

Ratings Score Snapshot

FG BCS Ltd.

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

Related Criteria

- 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
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- 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-/Positive/B	B-/Stable/B
BCS Prime Brokerage Ltd.		
BrokerCreditService Structured Products PLC		
BrokerCreditService (Cyprus) Ltd.		
Issuer Credit Rating	B+/Positive/B	B+/Stable/B

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