Broker opens gateway to Russian ruble liquidity

Impaired trading relations, economic sanctions and the plunge of the ruble have not stopped Russian brokerage ***Otkritie Capital*** from riding the volatility and breaking into credit intermediary markets

Both the FX prime brokerage area and the Russian markets have experienced some upheaval since early 2015. While the driving factors are different and therefore unrelated, the role of credit intermediaries in the currency markets has undergone significant shifts since the Swiss National Bank pulled its EUR/CHF floor.

At the same time, trading relations between international markets and Russia have been depressed by sanctions following the Ukrainian crisis and the subsequent dramatic fallout of the Russian ruble's exchange rate in December 2014. The collapse in the ruble rate resulted in the Russian currency weakening to historically low levels at the start of 2015, trading at around the 100 level, compared with a previous level of around 36.

However, the political winds are slowly changing, and local players are keen to get back to business. Grigory Kozin, head of prime services at Otkritie Capital, believes there is an important message international players need to hear: there is nothing to fear when doing business with Russian institutions.

Otkritie Capital is the UK subsidiary of Russia's largest privately owned financial group, Bank Otkritie Financial Corporation, which is Russia's fifth-largest bank by assets. Otkritie Capital has been present in the UK for 10 years and is regulated by the Financial Conduct Authority.

"We were established as a provider of Russian market direct market access (DMA) services to international clients. Ten years ago, the Russian market was nothing compared with what it is today and, together with the Moscow Exchange, we played an important role in this transformation," Kozin says.

Prior to 2010–2011, the foreign exchange pool on the Moscow Exchange was purely an interbank market and only banks could participate in trading. Liquidity in the Russian ruble is divided into three parts: the onshore pool traded on the Moscow Exchange; the onshore over-the-counter (OTC) liquidity; and offshore OTC liquidity, each comprising approximately one-third of the market.

"We are able to provide efficiency in terms of capital utilisation. If a client is hedged, we require much less initial margin because there is no market risk for us when the client is fully hedged" Grigory Kozin, Otkritie Capital

"Today, it's quite easy to access the Russian markets. We were pioneers in many aspects; for example, we were the first non-bank entity to begin trading FX on the Moscow Exchange," Kozin adds.

Now, to leverage opportunities due to trends in the FX prime brokerage area, Otkritie Capital is positioning itself as a new player in the credit intermediary space, offering a gateway to the full range of Russian ruble liquidity, as well as services to Russian clients in the international markets across all currency pairs.

"For 10 years, we have been providing DMA access to the Russian market as a rather diversified broker-dealer specialising in Russian risk and Russian liquidity globally. But we are a part of a large non-state-owned financial holding in Russia, which means that we are among the largest financial organisations in Russia that are not exposed to sanctions," Kozin says.

"This gave us a lot of opportunities, which we are exploring at present, including providing credit intermediary services for international clients to provide them with access to Russian ruble liquidity that was previously not accessible to them," he adds.

As a DMA house, Otkritie has a large algorithmic-trading-driven client base, including hedge funds, proprietary trading desks and alternative market-makers. While the deterioration in political relations between Russia and the West has had a negative impact on the appetite for Russian ruble trading, the interest from Otkritie's client base actually increased as volatility rose.

Ruble return

"After the Ukrainian crisis – and once the sanctions were put in place – a large proportion of Russian ruble liquidity came back locally onshore to the Moscow Exchange. Prior to the sanctions, the market was split roughly 50/50 between local markets on the Exchange and offshore OTC markets," Kozin says.

"After the sanctions came into force, the offshore portion of the liquidity market became negligible due to a lack of mutual limits between international banks or the largest prime brokers and the local banks that were providing liquidity," he adds.

This remains by and large the case today, and is prompting Otkritie Capital to enter the credit intermediary space, both in FX and other asset classes, aiming for $2.5 billion of client assets to be primed within the next two years.

While limits between local and international banks exist, they tend to be relatively small and utilised for purposes other than spot FX. This means that international players have no access to OTC local liquidity, which is dominated by large Russian banks, which in turn are unable to access the offshore liquidity pools on ECNs.

"We have partnered with the Moscow Exchange and we are also leveraging the large credit lines of our parent bank with other local institutions to provide access for international clients to local Russian OTC liquidity. We have a lot of local OTC interbank electronic liquidity, which is concentrated between four or five domestic banks, including our own bank, so this is now a focus area for us," Kozin says.

This area of liquidity is particularly interesting to alternative market-makers, who are looking for genuine, non-toxic flows to trade against. However, the push from Otkritie Capital is by no means focused solely on the Russian ruble. With over 200 international and regional clients and more than 30 markets covered, Otkritie Global Prime is committed to providing its clients with world-class prime solutions across currency pairs.

"Local OTC flow is one of the things international clients are trying to get access to, but there is also significant interest from Russian institutions looking for opportunities outside of Russia, i.e. the outbound flow. Russian institutions are seeking credit lines to trade not only the Russian ruble but other currencies as well, and we provide this opportunity by extending credit lines to these banks, which enables them to trade on international markets," Kozin says.

As a stand-alone entity, Otkritie Capital has a balance sheet of $370 million, which allows it access to good lines with Tier 1 global banks. On the other side, Otkritie Capital's parent bank has well-established and strong credit lines with local Russian peers.

Kozin says: "This means we are in a very good position to step into the FX prime brokerage space, and the prime brokerage space more broadly. We are an agency-only business and our core client base comprises recognised institutions across the globe, both on the buy and sell side.

"Additionally, we are able to provide efficiency in terms of capital utilisation. If a client is hedged, we require much less initial margin because there is no market risk for us when the clients is fully hedged."

Competitive advantage

On November 30, Otkritie Capital signed a new individual clearing membership agreement with the Moscow Exchange, becoming the first international broker to join as an individual clearing member. This will also allow Otkritie Capital to reduce settlement risk for both offshore and onshore Russian ruble trading on the Moscow Exchange and OTC.

"We are going live with our prime product now and we have a number of clients, large non-bank liquidity providers (NBLPs) for inbound flow, as well as a number of clients, mostly Russian banks, for outbound flow. In terms of access to liquidity, we are about to go live in a couple of weeks with access to our own FX platform in Russia, so we expect the first trade to clear within weeks," Kozin says.

"We view our natural competitive advantages, obviously, in trading the Russian ruble because we are Russian and we have a large bank behind us, which was one of the reasons why we decided to enter this space. However, now we have ambitions and the opportunity to compete with international prime-of-prime providers as well," he adds.

Currently, around 80% of the flows handled by Otkritie Capital involve the Russian ruble, but there are encouraging signs of an increase in other currencies due to the firm's pure agency model.

"I think we might be quite successful in the prime space because we have a good model. We don't operate as any kind of aggregator; we act purely on agency basis. We don't make any spreads so we don't create outside aggregation. We simply provide pure credit intermediation, settlement and technical access services – all of this is exactly what our target clientele requires," says Kozin.

"As a purely agency broker, we are keen to see more turnover rather than larger positions. For us, more algorithm-driven flow is preferable for inbound flows. Our outbound flow is a genuine bank and client flow, which is less interesting for us as a prime broker, but this might be very interesting for the high-frequency trading market-makers. This is what we will provide access to, and this sort of synergy arises from having good relationships with Russian local banks as well as with NBLPs," Kozin notes.

For now, the prime services will be for spot FX only and, to date, the broker has focused on Europe and the UK rather than US-based clients. This too may soon change, as the broker has received interest from US-based agency brokers seeking access to flows on the Moscow Exchange due to the time difference between the US and Moscow.

"In terms of accessing the whole scope of Russian local liquidity, ours is a unique proposition in the FX prime brokerage space. You need a strong balance sheet in the EU and, more importantly, you also need a large local bank. We have some good momentum behind us, and we are keen to capitalise on this," Kozin concludes.