

International Financial Centre in Moscow: What Would it Take? A View From Almaty

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The idea of Moscow becoming one of the global financial centres reflects a concentrated vision of a broad set of goals for the development of the financial system of the country and more active participation by Russia in the global financial infrastructure. It also reflects the country's intention to become the designated financial centre for the post-Soviet space. For this vision to become a reality, Kazakh, Ukrainian and Belorussian companies would need to change their listing preferences from London, Hong Kong, New York or Warsaw to Moscow. The CIS-based companies would turn to Moscow stock market only if they can successfully raise more capital on more favourable terms. That fact implies two questions. First, whether Russia's neighbours currently need Moscow as a regional financial centre to satisfy their needs. Second, under which conditions this might be the case.

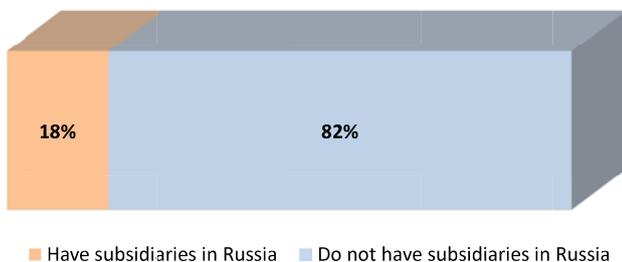
The recent study by the Eurasian Development Bank on the prospects of integration of the Russian and Kazakh stock markets provides food for thought.¹ Its findings are based on a survey of market professionals and issuers in both Almaty and Moscow. Market professionals include brokers, custodians, nominal holders, depositories and registrars, as well as portfolio management companies, and stock exchanges (MICEX, RTS, and KASE). Among the investors who participated were pension funds as well as Kazakh banks with sister companies in Russia and Russian banks and investment banks with sister organisations in Kazakhstan.

In the survey, professionals and issuers from both countries shared their plans and views with respect to listing preferences, problems, and their views on cooperation between the two countries. Results of the survey are supplemented by a comparative analysis of Russian and Kazakh regulations on stock markets.

Results of the Survey

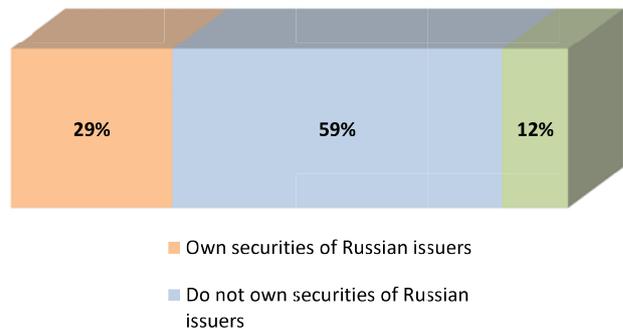
29% of Kazakh respondents hold Russian securities and 18% have subsidiaries in Russia.

Figure 1. Kazakh companies' subsidiaries in Russia



Most Kazakh organisations that already own Russian shares and bonds plan further acquisition of these securities. A high percentage (more than 30%) of those not owning Russian stock at present intend to purchase Russian securities. However, the respondents clearly indicated that Russian

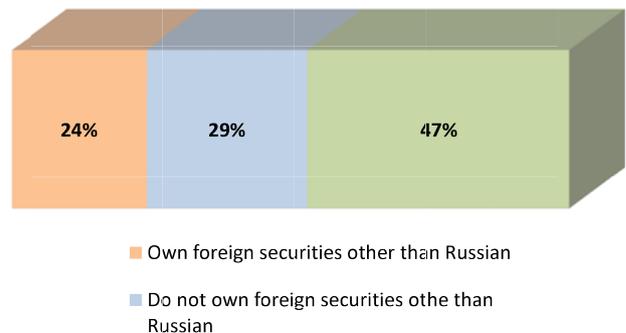
Figure 2. Ownership of Russian stock by Kazakh respondents



securities are often not purchased on the Russian stock exchanges, but via international stock markets in the form of GDRs and ADRs.

25% of Kazakh respondents hold securities of foreign issuers other than Russian ones.

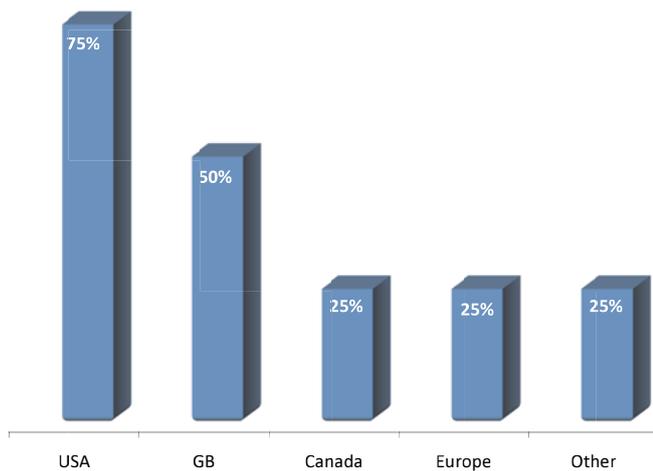
Figure 3. Ownership of foreign stock other than Russian by Kazakh respondents



The majority of them invest in the US securities (75%), with British securities coming second (50%), followed by those of Canadian and continental European issuers (25% each).

¹ EDB (2010). *Stock Markets of Russia and Kazakhstan: Perspectives of Integration, Industry Report 10*, Eurasian Development Bank, available at <http://www.eabr.org/eng/publications/AnalyticalReports/>

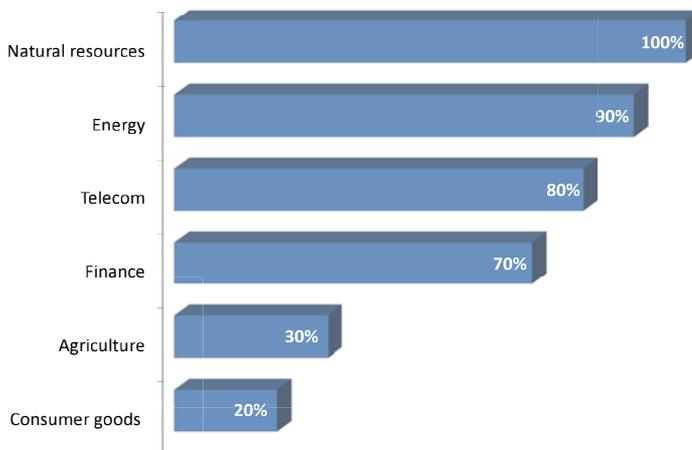
Figure 4. Kazakh ownership of foreign securities by country



Survey participants noted that the advantage of the stock markets in these countries is that they are highly developed and flexible, satisfying the needs of both the issuer and the investor. These markets, respondents stated, offer liquidity and a well regulated environment.

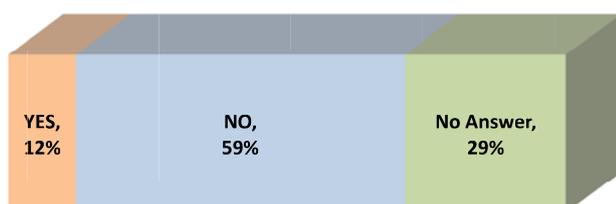
Kazakh professionals invest in the sectors where they have expertise, namely extraction of natural resources (100% of respondents), energy (90%), telecommunications (80%), and financial institutions (70%).

Figure 5. Priority sectors for investment for Kazakh professionals



Returning to our first question – are Kazakh issuers interested in the idea of Moscow as a financial centre per se? – we found that the majority currently do not consider Russian stock market for listing (59%) as primarily listing with the London Stock Exchange is a more attractive option and a well-beaten path. Only 12% are definitively interested.

Figure 6. Are Kazakh respondents interested in listing in Russia?



As for trading, Kazakh holders of Russian securities reported that they buy these securities via international markets in the form of ADRs and GDRs and are quite content to continue trading that way.

What are the challenges? When asked about their grievances concerning listing and trading in Moscow, respondents in Almaty and Astana unanimously pointed to legislative restrictions on the activities of financial institutions outside of their countries of registry. In particular, they drew attention to the following issues:

- the absence of a central depository in Russia;
- the issue of granting the rights of Russian securities nominee owner to foreign brokers;
- the absence of a mechanism to certify the rights of the effective holder of securities;
- legal restrictions on opening accounts with foreign custodians;
- the lack of recognition by Russia of licenses of professionals issued in accordance with legislation other than Russian.

At the same time, Kazakh respondents are thoroughly satisfied with the costs of doing business in Moscow as well as with the quality of services provided by Russian organisations. This includes speed, ease of access to and availability of complementary services, and the absence of failures.

Moscow as the Market for Rouble-Denominated Securities

To sum up, active integration of the stock markets of Kazakhstan and Russia is currently only of limited interest to traders and potential issuers. Thus, the making of the Moscow Financial Centre will require substantive work to increase the attractiveness of the regional financial solutions and instruments in a highly competitive environment. London and Hong Kong seem to be the main competitors as regards potential issuers from Kazakhstan and, for that matter, also from Ukraine and Belarus (Warsaw and Frankfurt are relevant for the latter two countries as well).

At the same time, our communication with the market professionals and the real sector companies points to one promising niche – the market for rouble-denominated securities, both shares and bonds.

The rouble has become convertible, and is gaining popularity as a regional trade currency. A growing percentage of trade between Russia and its neighbours is executed in roubles. For instance, more than 50% percent of Russian-Belorussian trade is executed in roubles. In particular, trade finance needs may be satisfied with relevant stock market instruments. Investments in the post-Soviet space are not flowing in just one direction, with a number of Kazakh, Ukrainian, and Belorussian economic entities investing in Russia. These investors may also tap into rouble-denominated resources to satisfy their needs in financial resources.

The options for the development of this market niche – ranging from listing rouble-denominated RDRs and bonds to further development of the derivatives market - seem to be considerable. In our opinion, this is a field where multiple short- and medium-term opportunities may lie.