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JPMorgan Sees Evolutionary Results From Financial Center Ambitions

By Howard Amos

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Costello is feeling optimistic about the strategic potential and continuing steps toward financial center status. **Howard Amos**

Though JPMorgan's Russian head, Jeffrey Costello, is keen not to be cynical about President Dmitry Medvedev's flagship project to transform Moscow into a center of international finance, he is also realistic.

"To look on Moscow as an international financial center as some vast thing which is going to transform Moscow overnight is wrong — it's evolutionary, not revolutionary," he told The Moscow Times during an interview in JPMorgan's new offices.

"It's much better to think of it as a way to mobilize political will around a whole range of different issues which make marginal but materially significant changes to the efficiency of the market."

The MIFC initiative, which has support at the highest levels of government, also allows the market to exercise influence over the law-making process, Costello said.

Legislation Improving

Industry experts say Russian legislation addressing the financial services sector is typically not subject to a proper consultation process, resulting in laws that are often not in harmony with the existing legal framework.

Medvedev, who first announced Moscow's financial center aspirations in 2008 on the eve of the financial crisis, has described the project as "Russia's great breakthrough into the world economy."

"We are at the organizational stage of setting up an international center," Medvedev said Sunday in Hong Kong. "I hope that we are halfway to our result," Interfax reported.

Costello, who joined JPMorgan in 2008 after a stint as chief executive of Brunswick UBS Warburg, cited legislation about financial tools and processes — like close-out netting, which regulates bankruptcy scenarios, and derivatives transactions — awaiting the president's signature before implementation in August, as an example of where the MIFC initiative has brought constructive change.

The new law, said Costello, 48, will give greater confidence in market transactions, make more credit available via derivative instruments and create a robust platform for exchange-traded derivatives.

However, the derivatives legislation had been sought by business leaders long before MIFC came along, just like another positive step: the introduction of a preferential work visa regime for highly qualified foreign specialists.

Ambition Has Effect

"Nobody cares about all this stuff [like derivatives and visas], and it's very difficult to get any political momentum to make it happen," Costello said, but it gets done as soon as you put an MIFC label on it.

Additional important changes that Costello says have to take place and are in the pipeline include changes to the rules around foreign nominee ownership, which now deny those holding assets through custodians the rights they would have under European or American financial systems — he said the current situation resulted in "distorted outcomes" — and the creation of one, centralized, adequately capitalized depositary, facilitating much larger volumes of securities transactions.

Only once these fundamental "plumbing" issues have been resolved, he added, can bankers start building the different types of financial instruments to trade on these exchanges.

At a meeting with Medvedev in March, Goldman Sachs Group chief executive Lloyd Blankfein said Moscow's awful traffic jams were the biggest single obstacle to the creation of a global financial center.

Costello, who moved to Russia in 1996 after stints in London and New Zealand, agreed that there had been little progress on the traffic issue.

"The traffic problem," he added, "won't be solved until people actually follow the rules."

Costello pointed to the efforts of 1990s New York Mayor Rudy Giuliani and his "don't block the box" initiative as a useful example.

Giuliani initiated intense policing of key intersections and levied heavy fines for those who blocked traffic by entering them when there was not room to exit the other side.

Industry Inputs

Medvedev appointed Alexander Voloshin, a veteran politician and former chairman of mining company Norilsk Nickel, to head the MIFC initiative in May 2010.

There are a series of working groups and project groups, focusing on a spectrum of different issues, functioning under him.

Numerous JPMorgan executives are participating in those groups.

Jamie Dimon, JPMorgan's chief executive, is on a 27-member committee reporting directly to Medvedev — one of 19 heavyweight international financiers involved.

"You have a framework," he said, "for market participants as well as government representatives to hash out how best to implement legislation and regulation."

But, Costello said that even the very existence of these structures will have an impact.

"The most positive development is that it is happening!"

Privatization Accelerator

JPMorgan was named as one of the banks that will play a role — possibly as bookrunner — in the upcoming slew of privatizations through 2015, amounting to some 1 trillion rubles ($35 billion) worth of sales and encompassing about 1,400 companies.

The process will include giants like state-owned oil company Rosneft, shipping firm Sovcomflot, diamond mining Alrosa and Sberbank, as well as hundreds of smaller firms.

Medvedev's chief economic adviser, Arkady Dvorkovich, said Sunday that the privatizations will be an accelerator for the MIFC project.

Turning to the situation in the Russian banking market as a whole, Costello said the growth of VTB Capital and Sberbank's acquisition of investment banking leader Troika Dialog was "a negative for the people competing against them, but a positive for the market."

Tough Competition

The fact of being state-owned gives VTB and Sberbank access to almost unlimited capital, an enviable position for their investment banking arms to be in.

Sberbank alone received 500 billion rubles ($17.8 billion) of subordinated loans from the government as part of the crisis bailout package for financial institutions. It has yet to return almost 300 billion rubles.

Prime Minister Vladimir Putin said Wednesday that the state had earned 200 billion rubles ($7 billion) on bailout loans distributed to banks during the crisis.

“There are something like 14 global investment banks operating in Russia, and now you have VTB Capital and Sberbank taking an increasingly large share of the investment banking wallet,” Costello said.

“How is that wallet going to be able to support 14 investment banks? It’s not — you’re going to see compression.”

The ranks of the retail banking market have already begun to thin. Though some foreign banks like Raiffeisen and Citibank have strong established positions, Barclays announced that it was pulling out of Russia in February, and there are rumors HSBC will soon follow in its footsteps.

Climate Improved

But Costello was upbeat about Russia’s investment climate in general, which, he said, got much more bad press than some other countries with equivalent risks.

“It’s amazing to me how much some parts of the media and investment community beat up the Russians while some other markets get a free pass,” the seasoned investment banker said.

JPMorgan has recently made big investments in India, Brazil and China — Russia is one of the next big strategic areas. Costello added, “It’s a pretty critical market.”

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