MOSCOW EXCHANGE

2Q 2019 IFRS Results Conference Call

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Moscow Exchange Speakers:

- Max Lapin, CFO
- Anton Terentiev, Director of IR

Participants asking questions:

- Sergey Garamita, Raiffeisen Bank
- Andrey Pavlov-Rusinov, Goldman Sachs
- Andrey Mikhailov, SOVA Capital
- Elena Tsareva, BCS Global Markets
- Andrzej Nowaczek, HSBC
- Andrew Keeley, Sberbank CIB
- Svetlana Aslanova, VTB Capital

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Anton Terentiev – Director of IR

Good afternoon everyone, and welcome to Moscow Exchange's 2Q 2019 IFRS results conference call. As usual, after the prepared remarks, we will have a Q&A session. Today, we have on the call our CFO Max Lapin.

Before we start, I would like to remind you that certain statements in this presentation and during the Q&A session may relate to future events and expectations and, as such, constitute forward-looking statements. Actual results may differ materially from those projections. The Company does not intend to update these statements to reflect the events occurring after the date of the call prior to the next conference call.

By now, you should have received our press release containing the results of 2Q 2019. Our management presentation is available on the Company's website in the IR section.

I will now hand the call over to Max Lapin. Max, please go ahead.

Max Lapin – CFO

Thank you, Anton. Thank you all for joining us today to discuss Moscow Exchange's financial results. Let me start with slide 2, a brief overview of delivery on strategic business initiatives since the start of the second quarter.

First, we have made several additions to the range of traded instruments. On-exchange futures on RUSFAR, the new Money Market benchmark, are now available in the Derivatives Market. Prior to that, we introduced overnight index swaps on RUSFAR in the OTC Derivatives Market. We continue to develop the benchmark, having recently added overnight RUSFAR in USD.

In the FX Market, a new currency pair, USD/JPY, started trading. This pair is available in standard order books, as well as for OTC trading. The latter is possible thanks to MOEX's service of providing access to global FX liquidity.

Yet another asset management company came out with two new Russian-law ETFs. Both these ETFs track Russian corporate bonds. This brought the total number of Russian-law ETFs listed on MOEX to twelve. We expect further additions in the near future.

Second, MOEX delivered several improvements to its services. Users of MOEX's OTC bond platform can now clear transactions through the CCP. This allows the expansion of CCP services onto securities not listed on MOEX, such as Eurobonds. Corresponding settlement is also available in foreign currencies.

The standardised OTC Derivatives Market connected to the Unified Collateral Pool. Participants of this market can now use securities as collateral.

In the Derivatives Market, we introduced online client registration. This reduced the registration time from almost one day to mere seconds, vastly improving the onboarding experience.

Third, we continued to develop our client base and partnerships. DCM was in the spotlight in the second quarter, as 71 corporate issuers placed bonds on MOEX. Of those, eight were newcomers to the public Bond Market. We also saw substantial interest in the Russian bond market from Belarusian issuers, both sovereign and corporate. They placed bonds worth RUB 15 bln in July and August.

MOEX deployed points of presence (PoPs, as we call them) in several new locations: Hong Kong, Singapore, Shanghai and Mumbai. They allow connectivity to MOEX's infrastructure for new clients based in these locations. In the absence of this solution, these clients would have to use PoPs in a place like London, which might be inconvenient for them.

Finally, Interactive Brokers, a global electronic brokerage with a large client base, obtained sponsored market access (SMA) to MOEX. We hope this solution will bring us additional foreign retail clients in due course.

RUSFAR – update on the new benchmark's development. We already talked about RUSFAR, Russian Secured Funding Average Rate, during the last earnings call. As we continue to develop the benchmark, I would like to provide a brief update. Today, 20 market makers ensure the liquidity of GCC repo with ruble settlement across different maturities.

In August, we launched USD-denominated RUSFAR in addition to the ruble RUSFAR curve. It reflects the cost of secured overnight USD lending in Russia. Unlike other benchmarks, it is the first "clean" indicator, meaning that it is unaffected by characteristics of a particular collateral.

As I mentioned, RUSFAR now serves as the underlying for two types of derivatives – on-exchange and OTC. Their trading volumes have just started to pick up. With interest rate derivatives being an underdeveloped segment in Russia, we hope these new products will make it more visible as the new benchmark obtains broader use over time.

Increased corporate activity on the Primary Bond Market. The second quarter saw a clear surge in DCM activity of corporate issuers as measured by both number and value of bond placements. Previously delayed demand for capital and expectations of a key rate cut drove that. Strong corporate activity persisted in July as well. To illustrate, a retailer Eurotorg placed its inaugural issue of RUB 5 bln in July, becoming the first Belarusian corporate issuer on MOEX.

In August, Fitch upgraded Russia's sovereign rating from BBB- to BBB, triggering upgrades on the corporate level. We expect this to have a positive effect on placements going forward. Also in August, MOEX created a Sustainability Sector for financing projects in the fields of environmental and social sustainability.

Later in 2019, we plan to allow trading of corporate bonds in T+ mode and introduce large block trading mode for OFZs, Russian sovereign bonds. We see these events and measures as supportive for further bond market development.

Summary of 2Q 2019 financials. Let us now turn to financials. Operating income increased by 9.0% YoY. Fee and commission income was up by 10.7%; net interest and other finance income added 9.4% YoY.

Recurring operating expenses (excluding the other operating expense line) were up by 10.6% YoY. OPEX growth for 1H 2019 was contained to 8.3% YoY, below the full-year guidance. The cost-to-income ratio improved vs recent quarters to 34.9%, the lowest reading of the last four quarters.

EBITDA adjusted for one-off provisions and movement in the IFRS 9 allowance grew by 9.6% YoY in the second quarter. The adjusted EBITDA margin improved to 73.1%. Adjusted net income increased by 8.7% YoY, and ROE bounced nicely to nearly 19%.

Fee and commission income increased by 10.7% YoY to another all-time high, driven by strong performance of the Money Market and Bond Markets, as well as Depository and Settlement Services. With the single exception of the FX Market, all other markets also contributed to fee income growth. We are particularly pleased to observe strong performance of equities and bonds. It reflects MOEX's standing as the principal capital-raising platform for the Russian economy.

Money Market. Money Market fee income increased by 14.5% YoY despite a 7.9% YoY decline in trading volumes. The latter is attributable to muted activity in interdealer repo as well as deposit and credit auctions – the two lower value-added segments. At the same time, trading volumes of the higher value-added segment of CCP repo (including GCC repo) increased YoY.

The discrepancy between fee income and trading volumes dynamics was attributable to higher average repo terms, UCP-linked fee rate revision, as well as a higher share of GCC repo.

The average term of on-exchange repo increased by half a day YoY to 3.6 days, but declined QoQ by nearly a day. The driving force behind changing terms was GCC repo, where a number of participants that previously entered into longer-term trades adjusted their strategies. Open interest in the Money Market moderated from the highs of 1Q 2019, but on average was still higher than in 2Q 2018.

Depository and Settlement Services. Fees and commissions from Depository and Settlement services rose by 19.5%. The main factor behind this was the usual growth in average assets on deposit. It happened across all asset classes, but especially so in government bonds. Volumes of repo with collateral management through NSD grew 42.7% YoY. This boosted income from clearing and collateral management.

FX Market. Trading volumes in the FX market declined by 11.5%. The product mix shifted toward swaps, as trading volumes of the spot segment declined by 32.3% YoY, partially because of subdued volatility. F&C income was down 15.2% YoY. The UCP-related fee rate change in the swap segment did support the effective fee, but the mix shift in favour of swaps dampened the effective fee.

In 2019 YTD, MOEX's FX trading volumes have been broadly in line with global peers. At the same time, the MOEX market share vs the onshore OTC market declined by 10 pp to 45% in 1H 2019.

To conclude with the FX Market, I would like to highlight a couple of positive developments. First, the number of active retail clients increased sizeably by 83% YoY in 1H 2019. Second, the ADTV of corporate clients surged by the same magnitude of 83% from around USD 30 mln to USD 55 mln.

Fixed Income Market. Bond Market F&C income climbed 36.3% YoY to a record level of RUB 752 mln. Trading volumes excluding overnight bonds increased by 20.3% YoY. Volumes of primary placements in the second quarter rose by 63.7% YoY. We saw growth in activity of both sovereign and corporate issuers. Volumes of government bond placements grew 4.0x YoY. Placements of Central Bank bonds also increased, although to a lesser extent than government bonds. This, coupled with robust activity of corporate issuers, supported the effective fee.

Derivatives Market. F&C income in the Derivatives Market grew by 4.9% YoY, while trading volumes declined by 12.0% YoY. The decline in volumes was attributable to FX and index derivatives. Volumes of more expensive commodity and single-stock contracts increased by more than 20%. Trading volumes of interest rate contracts, while still quite low, have started to become visible. Volumes in the OTC Derivatives Market grew by 46.4% YoY. OTC derivatives volumes were down QoQ, but growing average contract terms supported the effective fee. Over the last twelve months, the effective fee in the OTC Derivatives Market expanded almost 3x due to the emergence of longer-term contracts. Currently, the effective fee for OTC derivatives is higher than its on-exchange counterpart by an order of magnitude.

Option trading volumes declined by 29.9% due to low activity in strikes far from at-the-money levels, but trading of at-the-money options continued to pick up. The shift to more expensive contract types, support from the OTC Derivatives Market and the UCP-related fee rate revision helped the effective fee.

IT Services, Listing and Other Fee Income. Income from IT services, listing and other fees added 18.0% YoY. Listing fees increased by 90.7% YoY due to the scheduled tariff update and a higher number of bond issues. Sales of market data rose by 14.8% YoY on the back of the weaker ruble. Sales of software and technical services grew by 13.8% due to unification of tariffs as well as the weaker ruble. Other F&C income declined by 28.5% YoY due to a diminished contribution from the Grain Market.

Equities Market. F&C income from the Equities Market grew by 4.7% YoY in the second quarter. Equity trading volumes increased by 3.7% YoY, driven by higher market capitalisation. The average value of MOEX Russia index advanced by 15.7% YoY. The volatility of the index was higher YoY by almost 50%. MOEX's market share in trading of dual-listed stocks vs the LSE strengthened YoY by 6 pp to 68% in 2Q.

Quarterly net interest and other finance income advanced by 9.4% YoY. Core NII, i.e. NII excluding realized gains on the investment portfolio re-evaluation, was virtually flat YoY. Funds available for investment grew by almost 5% YoY, mostly due to contribution of EUR-denominated client balances. The share of EUR-denominated client funds went up YoY from 54% to 63%.

Operating expenses grew by 10.6% YoY. This can largely be accounted for by personnel expenses that rose by 17.8% YoY due to a combination of four factors. First, the timing factor. The bonus provision reversal happened in 1Q 2019. In the base year 2018, it happened later – in 2Q 2018. This mismatch lowered the OPEX of the base and technically inflated the OPEX for 2Q 2019. This effect explains 7.3 pp of growth out of 17.8%. Second, 4.5 pp came from salary revisions. Third, 4.2 pp of growth were due to higher headcount as we hired people for new projects. And fourth, 1.8 pp resulted from a hike in social charges that we outlined at the beginning of the year. Professional services costs declined by 31.9% YoY due to lower pass-through cost of the Grain Market.

In 1H 2019, OPEX growth was 8.3% YoY, below the lower end of the guidance. We are now revising and narrowing OPEX growth guidance from 9–12% issued earlier down to 8–10% for the full year. We also lower CAPEX guidance for the year to RUB 2.0 - 2.5 bln.

Concluding the presentation, I would like to touch upon a couple of additional topics.

First, interim dividends are not on the agenda. We have been calling ourselves an annual payer for the last 11 months, so the market has no expectations of an interim dividend. I would like to reiterate this once again – all dividends for 2019 will come in 2020 as a single payment.

Second, there were certain changes in regulations that affect the regulatory capital of the Group. Moscow Exchange, as an organiser of trading, is now obliged to hold capital on top of NCC's and NSD's capital. Therefore, the trading engine now has its own regulatory capital of RUB 5 bln. One can interpret this capital as restricted cash, which is investable but unavailable for dividend distribution. But we have that money as cash or cash equivalents anyway, so no new capital is required.

Overall, the regulation of financial institutions in Russia is evolving. The ideas are under discussion. Changes, if any, would affect the entire financial system, not just us. We will keep you updated during next calls as and if novelties become tangible.

This completes my remarks. Let us open the line for questions.

Operator

Thank you. The first question comes from the line of Sergey Garamita from Raiffeisen Bank.

Sergey Garamita – Raiffeisen Bank

Thank you for the presentation and congratulations on excellent results. My question regards the sustainability of the high average fee, especially in the Money Market. As we can see from the slide on the Money Market, there is a chart of open interest. And we can see that in June, the open interest was almost on par with the figure for June 2018. Do I understand it correctly that probably in 2H 2019, the average fee will be lower than in 1H 2019?

Second question. There is an income tax one-off in the cash flow statement, as I understand it. There were some income tax prepayments and also the reduction in income tax liabilities, which kind of pressured your operating cash flow in 2Q 2019. Is this effect going to be reversed later this year or not? And did I get it right that you are able to pay everything you earn now, almost 100% of net income or more, provided that your capital does not change? Is that your message or not? Thank you.

Max Lapin – CFO

A good set of questions. Thank you, Sergey. Let me dissect them one by one. We would compare the sustainability of fees in the Money Market YoY between the subsegments of the Money Market. Inter-dealer repo is down by around 40%, and direct repo with the CBR is virtually nil. That means that the share of lower-priced repos in the overall structure of the repo market declined compared to the last year. Consequently, we have higher average fees because of the migration into repo with the CCP. The share of repo with the CCP is now at its historic high – 88%. That means that the market is moving on to the centralised solution. The difference between inter-dealer repo and repo with the CCP of comparable durations is to the tune of 4x. Repo with the CCP is 4x more expensive. Within repo with the CCP, the share of GCC repo is also improving because of the standardised collateral service management that the clients prefer. And we are still onboarding corporates to the Money Market. We already have 100+ corporates, with the average onboarding speed of about one additional corporate a week over the past two years. And we will continue to do that and add new clients.

The Money Market is a mature market. It is hard to drive further growth of the Money Market as the share is saturated and the new demand that we are getting is mostly coming from new types of clients, like corporates. Given the substantial liquidity overhang in the Russian market, I would think that the Money Market has chances for further growth, but it will be a rather limited one compared to the previous results when we were saturating the market and building new product presence.

But let me reiterate our plans for the Money Market. According to different rating agencies and business publications, there are 400–600 large corporates in Russia. Every one of them is a potential client for us. We are talking to all the corporates and onboarding them by one a week on average. This trend will continue and we will tap into corporates in the future.

The second question was on taxation. Yes, tax assets and liabilities fluctuate. I would encourage you to look at the average taxation rate. The average effective income tax rate will be relatively stable. It is not fluctuating that much. If you see the migration of tax assets and tax liabilities between quarters, on average, they will cancel each other out on a rolling 12-month basis.

Switching to the dividends question. We explained this a lot throughout the past year. We still adhere to the logic that we strive to pay as dividends the cash that we do not need for the capital of the banking subsidiaries, such as the clearing centre, the depository, and the trading engine itself, and for CAPEX and development of new projects.

During our earlier calls in regards to the development of capital requirements, I mentioned two facts. First, our CAPEX requirements are not that high. Historically and this year again, our CAPEX is roughly 10–12% of net income, give or take. And even if you look at the largest project that we have been working on – the Marketplace, the overall development cost for that project is below RUB 1 bln to have it done as an infrastructural solution. That means that we do not have high capital requirements for the development of new products that support our further growth. We are not a CAPEX-heavy company. And with the dividends, I expect to get that question in the future as well, and I will repeat the same thing again. We have a track record for several years straight of RUB 7+ DPS. We have a track record that we are capable of delivering on good dividend payments. We have explained the logic behind the dividend payments many times. It stands the same.

So, thank you, Sergey. If you need additional clarification, just let me know.

Sergey Garamita – Raiffeisen Bank

Thank you.

Anton Terentiev – Director of IR

While we are waiting for further questions, I will read one from our webcasting interface. It comes from James Thursfield. It is about the FX. He is asking, "What do you attribute the decline in volumes and income from the FX segment to?"

Max Lapin – CFO

There are two major factors, with a roughly 50/50 split between them. One is macro. The volatility is down YoY again in the FX, and we are recipients of short-term volatility. The higher the volatility, the better are the velocities in the FX Market.

The second thing is the share of the overall onshore FX market. Our share vs OTC declined because the competition is toughening. The FX Market is a competitive market where banks and platforms are present. For this reason, we are looking into building an OTC FX platform in Russia. The logic behind the OTC FX platform in Russia is that we have on-exchange trades in the FX, which are mostly order-driven trades, so the price might fluctuate, and we want to have a competitive OTC solution that would be quote-driven and would behave like a standard OTC platform to reach all other market participants while staying familiar because a similar [on-exchange] platform already exists. So, we are looking into developing the OTC FX market with the exchange.

OK, let me take the next question.

Operator

The next questions come from the line of Andrey Pavlov-Rusinov.

Andrey Pavlov-Rusinov – Goldman Sachs

Good afternoon, gentlemen. Thanks a lot for the presentation and congratulations on the results. I have several questions. First of all, I would like to discuss the NII dynamics. Based on our calculations, it looks like your ruble yield strengthened throughout 2Q 2019, maybe a lagged effect of a higher rate environment early in the year. Going forward, what should we expect in terms of the effect of the CBR's recent rate cuts by 50 bps? So would it be felt already in 3Q 2019? Or is it likely to also come with a certain lag? When should we expect it to be felt?

Max Lapin – CFO

A good question, Andrey. On the NII, the average yields are a little bit up. If you look at the NII altogether – not just the core NII, but also the realised gains – the realised gains drove the weighted average yield, and the realised gains were from the sale of some of the portfolio. In the longer term, the ruble yield of the portfolio is indeed a recipient of the decrease in the CBR's key rate. The question is how fast it will show up in the results. The duration of the ruble portfolio is up to 18 months. So, I would say that you will see a slight chunk of that decrease in 3Q 2019, but you would not be able to dissect it from the reporting. It will become more visible by the end of the year, and then it will have a pretty substantial impact over the course of next year. So, it does have some lag. It is not immediate.

Anton Terentiev – Director of IR

I should also remind that about 60% of our ruble income comes from securities and 40% from money market [short-term] instruments. Those money market instruments are repriced pretty much instantly, while the securities portfolio stands until we rebalance it, irrespective of the CBR's rate changes. Plus, within the structure of the securities market in Russia in general, we have sovereign securities with a floating coupon that is backward-looking and reprices with a quarterly lag. That also might affect the results.

Max Lapin – CFO

You had another question, Andrey. Please proceed.

Andrey Pavlov-Rusinov – Goldman Sachs

Yes, I do. Thanks a lot for that. My second question is just a follow-up to your dividend thinking. You have mentioned that you are also now facing RUB 5 bln capital requirements for your trading organiser activity. Does this change in any way affect your thinking about the full-year dividend or not really?

Max Lapin – CFO

Not really. Let me deep dive into that a little. We have always had an internal policy with regards to the trading engine, to the legal entity of MOEX itself, that it should have approximately a half a year reserve for expenditures – for operational risk management. What happened is that this internal regulation, the risk management procedure, has been officialised by CBR regulation. We received a notification of that about a year ago, and it went into effect this year. But let me assure you that we have always had that kind of policy internally to have cash as an operational stability reserve for the exchange. That is why I mentioned that no additional capital is required for MOEX, as a trading engine, to go on further. So, this did not change visibly the capital requirements since the restricted cash has been in place anyway. It has just been officialised by the regulation.

Andrey Pavlov-Rusinov – Goldman Sachs

OK, that is pretty clear, thanks a lot. And my final question is about the dynamics of the fee yields. I just wanted to check what was the effect of your usual deferrals on the Derivatives and the Money Market front? I think, last time, the derivatives yield benefitted from deferrals. So could you please just clarify what happened this quarter in the Derivatives and Money Markets with deferrals?

Anton Terentiev – Director of IR

Okay, Andrey. Speaking about the Derivatives Market, deferrals both on YoY and QoQ basis have negligible effect on the effective fee in the Derivatives Market, meaning they are very, very similar in magnitude in the two quarters of 2019 and 2Q 2018, the base quarter.

In the Money Market, there is a little effect. But, again, very similar figures for 1Q 2019 and 2Q 2019 and a little bit higher deferrals figure for 2Q 2018. No big deal there at this time.

Andrey Pavlov-Rusinov – Goldman Sachs

Understood, thanks a lot.

Max Lapin – CFO

Thank you, Andrey. Next question, please.

Anton Terentiev – Director of IR

I will read out another question from James Thursfield – Global Investor Group. How do you plan to boost overall volumes in the Derivatives Market after this 12% drop?

Max Lapin – CFO

With the Derivatives Market, it is the question of the structure itself. The part of the Derivatives Market that dropped was the FX derivatives. FX volatility is down, FX derivatives are down, we are recipients of volatility here. We are fortunate to have such a fee structure that FX derivatives are priced lower than commodity derivatives, which are on the rise. We are undertaking two types of actions to support the Derivatives Market. First, we are launching new instruments. We have been talking a lot about commodity derivatives before, and we will be looking into new underlying assets going forward. It is natural development of the Derivatives Market business line. The second thing we are talking about is OTC derivatives. Trading volumes of OTC derivatives are up YoY, although down QoQ. We are looking at that as an opportunity to develop the OTC market further. We know it can work. We know that we can onboard more clients there. Our OTC derivatives platform is definitely up for further development.

But all in all, the Derivatives Market is far more sensitive to volatility than other markets.

Anton Terentiev – Director of IR

We are ready to take the next question from the queue.

Operator

Thank you very much. The next question comes from the line of Andrey Mikhailov from Sova Capital.

Andrey Mikhailov – Sova Capital

Thank you very much for the call. I have three questions. The first one is on those grain losses and insurance – in particular, whether you now have more clarity on what part of the losses can be covered with the insurance. The second question is on OTC derivatives. They did grow visibly YoY, but they fell almost 4x QoQ. Is there any seasonality there? The third question is on the Marketplace project – I would be grateful if you could elaborate on this and give a bit of an update. Thank you.

Max Lapin – CFO

Thank you, Andrey. Great questions. On the grain loss – first, the size of the provision itself at RUB 2.4 bln is stable. By stable, I mean that we recognised all the losses possible, provisioned for every potential loss. Any fluctuations come from changes in grain prices, but it is not much, it is not that sensitive.

By provisioning in full I mean that in May and through 2Q 2019, we went elevator by elevator to double-check the grain balances with the surveyors. We unwound all swaps. During the last call, I said that the grain swaps would be extended to the end of the year. We unwound all swap positions, so there is no additional risk related to the swaps. The swaps section of the market is effectively stopped, so there is no risk. That means that in terms of origination of new risk, there is none. The size of the provision is recognised in full. The sensitivity of the reserve is only to price changes, but it only applies to a fraction of the reserve – approximately 15–20% of the reserve might be sensitive to the changes in the grain prices, not much.

The next question is what we are doing for the recovery. We opened a criminal case. We are participating in the bankruptcy procedures. We are claiming our rights to any grain that we can find, and we have had such precedents. We are engaging in negotiations with the owners of the grain storage facilities so that they would be able to pledge their other assets at the deal settlement. So yes, we are utilising all of those measures.

With the insurance itself, we filed the full package of insurance documents, including the criminal case confirmation, in June. The insurance company is looking at the claim, and they are likely to run an additional investigation. It might take another couple of months, give or take – I don't know, it depends on their procedure. Then they will make the decision on the settlement of the insurance claim. So far, I would reiterate again, the insurance has not been covering all the size of the reserve itself and all the size of the loss. I would not be making forward-looking statements here due to the unpredictability of the insurance claiming process. We will recognise the insurance funds against the reserve only when the cash hits our accounts. By IFRS standards, I will not recognise the potential recuperation of the provision before I have the money in the account. Even if the insurance company decides, I would still be looking for the money in the account before I wind down the reserve. So let me, therefore, not yet manage your expectations on that.

With the OTC derivatives, we are studying the market. There might be some seasonality. Anton, would you comment on that?

Anton Terentiev – Director of IR

When we had these elevated volumes earlier, the participants were testing the market and engaging in short-term deals. Now they are engaging in longer-term deals, so we are not expecting much of a seasonality there. It is just about the transition to longer-term contracts, and we mentioned that during the introductory speech.

Your final question is about the Marketplace, which coincides with the question of Boris Zhilin, and he is asking that question through the webcasting interface. Thank you for that question, Boris.

Max Lapin – CFO

As for the Marketplace, we are developing the infrastructure solution internally. Effectively we are doing the coding. We still need the digital passport law that would enable the Marketplace to work. Once the law is in place, we will be able to ramp up the project quickly enough. On our side, we are developing the system, even though there is not yet the regulation on that. We want to hit the ground running once the law is in place.

I would like to draw your attention to yet another question that I have been expecting but have not received yet. We had a legal case provision last year. We unwound that provision in 1Q 2019 and in the annual reporting for 2018. We received additional good news this summer. Let me briefly remind you of the story. Last year, a bankruptcy manager filed a claim to unwind some on-exchange deals. Eventually, the cassation court denied that claim, and the bankruptcy manager went to the Supreme Court. The Supreme Court denied the claim to review the cassation court decision. Finally, on 10 July 2019, we got the official statement by the Supreme Court that this claim is not valid, that the cassation's decision stands. That means that we unwound the provision in full and did it correctly.

In August, a similar decision was made on a totally unrelated case when another bankruptcy manager wanted to file a claim against the Exchange. They were denied in the very first hearing of the very first court. That means that we have set a precedent that the bankruptcy law is separate from the clearing law, and specifically for an on-exchange deal, the clearing law, as the most specific law, supersedes the bankruptcy law. That means that we have our system legally protected and that similar cases are not at all likely to be won by claimants in the future.

I want to stress that it is one of the most important decisions that we had from the court system this year, because it fully protects us, and it fully confirmed that the legal framework we had developed for the Exchange over the past years has been done correctly and worked out correctly.

Anton Terentiev – Director of IR

I shall add a comment to the previous question, as Boris was particularly interested in the long-term economics of the Marketplace. It is a little bit premature to elaborate on economics. I would just remind you that our calculations and our assessment of this project were based on a few things such as the market share, the annual turnover of RUB 1 trn that we are looking at, and the range of fees that elevates this project to RUB 1 bln scale in revenues on an annual basis. These calculations and this understanding still stand, but we need to get a regulatory framework and legislation first to continue with this project and to provide you some more information on that.

Operator

The next question comes from the line of Elena Tsareva from BCS Global Markets.

Elena Tsareva – BCS

Hello, thank you for the call. My question is what the potential implications of the new sanctions on markets could be – maybe for the Fixed Income Market, in terms of new placements of sovereign debt. Or do you not see any risks like this and think that this is more or less neutral? Also on the same subjects of sanctions – do you know about any implications for EBRD – in terms of new sanctions – and its stake in MOEX? This is my first question.

Anton Terentiev – Director of IR

The new sanctions you are referring to apply to USD debt, which we do not administer. For us, this particular set of sanctions means nothing as we administer ruble sovereign debt. We are, of course, thinking about risks all the time, as do other market participants, but this particular set of sanctions seems to be inapplicable to what we do. Regarding the EBRD, we have no new information from them. The last time we spoke to them, they did not identify themselves as sellers or whatever. We are where we are at the moment, nothing new.

Elena Tsareva – BCS

Many thanks. My second question. You introduced the real estate index, and potentially you have an ETF on the index. Could you share any estimates you have for this type of product, and information on any similar products or initiatives you may have in the pipeline?

Max Lapin – CFO

Good question. The Russian-law ETFs market on Moscow Exchange is a new market, and a small-ish one. It is a subsection of the equity market. For the ETF market and all other indexes, like the real estate index, to pick up, they have to have a broader range of clients who are migrating to the Moscow Exchange. With the ETFs, the customer journey that we would expect is that customers first switch to bonds or bonds ETFs, and then to equities and equities ETFs. It will require education. We are very much reliant in that education on our partners – the asset managers and banks who are launching these ETFs and support the indexes.

Retail clients are booming, and individual investment accounts are on the rise. Every month, we have 100,000 new clients. The retail demand is growing. It is in relative infancy, but the client base is being cross-sold by the large banks. They cross-sell brokerage services and funds to their clients, and we would expect that to grow. But another thing that needs to happen is that people have to get accustomed to the equity market and the ETFs subsection of it. I think it will take some time. Whenever I am asked about how long it would take, I say that culture is a long thing. Looking at retail clients, we are talking a longer-term potential for growth – let's say, a five to ten years horizon, helping the equity market to grow. It is not like a one year pick-up like with corporates in the Money Market. Rather, it is a profound, fundamental, but longer-term impact on the equity market.

Operator

The next question comes from the line of Andrzej Nowaczek from HSBC.

Andrzej Nowaczek – HSBC

My question was on grain, and it has been answered. But since we still have some time, I wanted to ask about securities gains. Bond yields have, of course, fallen. Bond prices have gone up. As of the end of 2Q 2019, you have this large revaluation reserve in your equity account – that was RUB 725 mln at the end of June, presumably significantly bigger today. Are you planning to lock in some of those gains again in 3Q and 4Q 2019?

Anton Terentiev – Director of IR

Okay. Andrzej, this might happen. We do not necessarily foresee that, but with the gain that is a fact of 2Q 2019, it is just driven by market opportunities, so we decided to fix some profits, on Eurobonds in particular.

Andrzej Nowaczek – HSBC

OK. So opportunistic then?

Anton Terentiev – Director of IR

Pretty much.

Andrzej Nowaczek – HSBC

Thank you very much.

Operator

Thank you. The next question comes from the line of Andrew Keeley from Sberbank.

Andrew Keeley – Sberbank CIB

Good afternoon. Again, my questions have been answered, but I do have a question on your costs. I am trying to think about costs heading into next year. Obviously, if we look at this year, you have had higher expenditures on the Marketplace and staff hires relating to that. You have also had the offsetting benefit of lower professional services costs. Would you say that in terms of staff hiring, you would expect less need for new hires heading into next year? In terms of the Marketplace and given the pushing back of the legislation, can you give us any idea of what percentage of the Marketplace costs are expected to fall into this year and what percentage into next year? Thank you.

Max Lapin – CFO

Wonderful question, Andrew. On the staff numbers, the FTEs drove the costs in 2Q 2019 up by approximately 4% YoY following the headcount change. It has been happening a little bit slower than we expected because of the slowdown in the Marketplace legislation. We decided to proceed with the development of the platform, just not do it at the full speed. We are doing it at half speed. Therefore, this year, the expenditures on the Marketplace are going to be a little bit lower than we expected. They will be smaller than RUB 1 bln. We will have some additional hiring pushed to the next year. This is exactly why I lowered the OPEX guidance from 9–12%, which stood for a higher speed of development of the Marketplace, to 8–10% that stands for a lower speed of development.

Although next year, we, indeed, will have additional hiring for the Marketplace and similar things, in the longer term, we have a history of our cost basis growing lower than our fees and commissions. We aim for our fees and commissions to grow faster than costs, so we want to have good leverage in there. Longer term, we will strive to maintain the same rate of cost growth (CAGR) as before, which is, give or take, 8%. Going forward, we will be looking to achieve that.

The logic is that we want to have a business model with a high potential to improve its cost-to-income ratio with the expansion of the business. We have a semi-fixed business model as we do not have that much of a variable cost. We want to utilise our fixed cost base so that we can do more trades and support more volumes with relatively stable headcount.

Andrew Keeley – Sberbank CIB

OK, that is very helpful. Just a quick question, I am not sure whether you mentioned any update on the provision that was taken in 1Q 2019 relating to the incorrectly processed payments. I think when you had the 1Q 2019 call, you said it was under investigation and you would comment later. Is there anything on that?

Max Lapin – CFO

The provision is down by RUB 30 mln. You might see that in the note. There is some recovery, and we are working on that as well.

Andrew Keeley – Sberbank CIB

OK. Would you say there could be more recovery on that?

Max Lapin – CFO

The provision is currently conservative, it is the same logic we applied with the Grain Market. Let us see how it evolves.

Andrew Keeley – Sberbank CIB

OK, thank you.

Operator

Thank you. The next question comes from the line of Svetlana Aslanova.

Svetlana Aslanova – VTB Capital

Thank you. I have two small follow-up questions. Speaking about OPEX, we discussed the development of the staff costs. If we look at the other expenses growth, I understand that the situation in the Grain Market significantly decelerated growth in this segment. What do you see as a run cost for the coming quarters if we assume that operations of the Grain Market do not recover? Thank you.

Max Lapin – CFO

If I might ask you to clarify the last sentence. What exactly did you mean by no recovery in the Grain Market?

Svetlana Aslanova – VTB Capital

As far as I understand, there were some costs in this line that were related to the Grain Market. At the moment, as we see, this item is lower, in particular in 2Q 2019. What kind of performance should we expect?

Max Lapin – CFO

We have the professional services there. I am referring to the decline of professional services costs. We had the reimbursable (pass-through) cost on the Grain Market. As for the baseline level for this expense line, the 2Q 2019 level is more or less the normal level, relatively unaffected by the Grain Market. Professional services to the tune of RUB 100 mln a quarter seems to be a robust number. Until the Grain Market is restarted, that expense line with the pass-through cost in it is not expected to change.

Svetlana Aslanova – VTB Capital

To change, yes. OK.

Anton Terentiev – Director of IR

Let me remind you that there are two lines reflecting each other and going hand-in-hand. These are Other fee income and Professional services. Reimbursable costs from Professional services then go to Other fee income. These two lines are subdued, as you see, and that is what we expect going forward.

Svetlana Aslanova – VTB Capital

Thank you very much. I have another question, just to clarify. I remember that previously you disclosed that the new strategy might be announced by the end of September. Is this still the case?

Anton Terentiev – Director of IR

OK. Svetlana, the strategy is being finalised. As soon as we get the date internally, we will announce it promptly. So far, we are looking towards mid-autumn, and that is the only update I can give you at the moment. Once we are ready, we will tell more.

Svetlana Aslanova – VTB Capital

OK, thank you very much.

Operator

Thank you. The next question comes from the line of Sergey Garamita from Raiffeisen Bank.

Sergey Garamita – Raiffeisen Bank

Thanks again. My most important question on strategy has already been answered. My second one is a follow-up on this legal case provision. The remaining sum, as far as I remember, was something above RUB 200 mln. As you have clearly said, the case was won by you. When do we expect the reversal of the remaining sum of the provision in your reporting? Is it next quarter or maybe by the end of this year?

Also, as a clarification on OPEX, you said that you see growth in OPEX at around 8% further on. Does it include the extra OPEX for the Marketplace next year, or is it the figure after that longer term? Thank you.

Anton Terentiev – Director of IR

Regarding the legal case, we actually released the provisions for that before. 75% of the provision were out in 4Q 2018. The remaining 25% was out in 1Q 2019. We had a very good understanding that the case was about to end in our favour. What Max mentioned is that the case did end in our favour, and it is completely over.

Max Lapin – CFO

The number that you are referring to is for the expected credit losses, and it falls into that section of the IFRS. It changes quarter-on-quarter. That is it. Those two numbers are not correlated.

Anton Terentiev – Director of IR

We have our investment portfolio, and under IFRS 9 we are obliged to keep a bit of technical provision for expected credit losses, which we actually do not expect to ever happen in real life. We just keep it in our accounts as per the standards.

Sergey Garamita – Raiffeisen Bank

OK, thank you. And on OPEX?

Anton Terentiev – Director of IR

For OPEX, 8% to 10% is the guidance for this year. For next year, I do not think we are ready to provide guidance, because we have just started the budget process for the next year. It will be completed by early December. Max, if you can add anything.

Max Lapin – CFO

Please expect an updated guidance for the year at the next call for 3Q 2019 as we did last year. That is going to be in the fall. The new guidance for the coming year will be released with the annual report. At the annual call in early 2020, I will provide the guidance for 2020. We are not providing longer-term guidance, and I would like to reiterate that our strategic development is not CAPEX-heavy. The majority of developments is happening at the usual cruise speed through OPEX. I would not be expecting huge fluctuations there at all.

Sergey Garamita – Raiffeisen Bank

OK, thank you.

Operator

Dear speakers, there are no further questions at this time. Please continue.

Anton Terentiev – Director of IR

We will wait for maybe one more minute to see if there are any follow-up questions. I think we have already set a new record for the length of a Q&A session, at least for the era of Max and myself.

Max Lapin – CFO

Thank you, Anton.

Anton Terentiev – Director of IR

I am checking the webcasting interface. We have no further questions here. Thank you very much, everybody, for your very good and insightful questions. I am looking forward to speaking to you at the next call.

Max Lapin – CFO

Thank you.

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