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IN A CHANGING WORLD

YOU NEED INSTANT INTELLIGENCE ON YOUR KEY MARKETS WORLDWIDE

The bank for a changing world

BNP PARIBAS

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We find ourselves in a political, economic and financial environment that is increasingly difficult to predict.

As the bank for a changing world, we are committed to identifying and understanding the changes that impact your business, helping you to turn them into opportunities.

Our latest edition of Quintessence offers insights into the issues and forces impacting our industry:

Changing technology: Established financial services firms and their clients can benefit hugely from joining forces with fintechs, as BNP Paribas Securities Services’ partnership with Fortia Financial Solutions has proved.

Changing horizons: Some 25 years after their stateside introduction, exchange traded funds (ETFs) continue to proliferate on a global basis. ETFs have since expanded into emerging areas, including Latin America. Domestic pension plans and other asset managers in Brazil are expected to boost ETF adoption as a way of gaining access to the US and other key markets that may be otherwise off-limits due to cross-border restrictions.

Changing attitudes to risk: The United Nations Sustainable Development Goals (SDGs), set in 2015, have become an important catalyst in shifting attitudes on creating a socially responsible business. What has the financial services industry contributed towards meeting the goals and which of the 17 goals have seen most progress?

Changing regulation: The Fintech Action Plan was announced in March 2018 by the European Commission to support innovation in European fintech, while managing the risk that disruption can create. As a supporting initiative to the Capital Markets Union, it is intended to help harmonise the approach that national competent authorities take towards a range of fintech services and technologies.

Changing business models: Have brokers in the Asia-Pacific region reached a tipping point? In a dynamic, fast-changing region, can the historical models of self-clearing or account operator still allow brokers to compete successfully? Or is third-party clearing a solution to help market participants adapt to new technologies, regulations and settlement standards?

We hope that Quintessence brings you valuable insights and will help inform your decisions in 2019 and beyond. We look forward to lively debates on these topics. Feel free to discuss them with your relationship manager or get the conversation flowing via Twitter (@BNPP2S) or our LinkedIn company page.
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TALES OF THE UNEXPECTED

While we appear to be in a period of unprecedented upheaval, Head of Brokers Market Strategy at BNP Paribas Securities Services Alan Cameron explains why change is the only constant in a post-trade world.

In the last 30 years, we have introduced immobilisation, dematerialisation, versus payment settlement, central counterparties, standardised and shortened settlement cycles, while expanding our geographical and asset class coverage. At the same time, our working environment has been revolutionised with the introduction of the internet, digitalisation, the euro and T2S.

Change can be predictable or unexpected. Businesses that manage predicted change and anticipate unexpected change will thrive.

Through the looking glass
At BNP Paribas, we think of change in the context of five axes – horizons, regulation, technology, business models and risk. In this article, I will outline the predicted changes for each axis, hazard a guess about the unexpected changes that might come and consider how we can better anticipate unexpected change.

Our horizons have expanded geographically and we can predict that, with the continued global rise of capitalism, they will continue to do so. This geographical expansion has to be managed. What is not so easy to predict is the growth of new asset classes. The growth of derivatives, ETFs, tracker funds, securitisation and swaps surprised many in the industry. Anticipating the emergence of unexpected new asset classes will be difficult. We should expect the unexpected.

For regulation, we can anticipate that there will be a continued focus on withstanding – and ideally reducing – risk. Our regulators will ensure that market players are well capitalised, and that they understand, measure and consider the risks that they take.

Outsourcing is becoming the preferred business model. It develops from being driven by tactical levers, to becoming strategic and then to mutualising services. In the post-trade world, outsourcing is starting to become strategic, so we can predict that our business models will further develop, with more and more back-office functions being outsourced. The timeline might be debated, but the direction of travel is clear. What is unexpected is moving to a business model beyond outsourcing where full post-trade processing can be bought ‘as a service’.

Since the financial crisis, managing risk has become measured, automated and industrialised. There is increased focus on taking and measuring collateral. This is embodied in the continual rise of central clearing. We can presume that this will continue. What is less predictable is how our industry will address the many more ambiguous risks that we face, such as conduct, reputational and geopolitical risk. Equally, the impacts of operational

“We have to be brave. We do not always have to fall in with the prevailing view. Sometimes, we need to trust our instincts... we have to find the courage to act and behave like an entrepreneur”

It is harder to anticipate what regulators will do about growth or, rather, the lack of it. However, we do at least know that this is high on regulators’ agendas.

Technology has shaped our post-trade world and will continue to do so. We can envisage that artificial intelligence and machine learning will make us more efficient. However, distributed ledger technology could bring unexpected and more fundamental change – potentially upsetting the building blocks that our post-trade world is built upon.

"We have to be brave. We do not always have to fall in with the prevailing view. Sometimes, we need to trust our instincts... we have to find the courage to act and behave like an entrepreneur”
risk and cybersecurity threats are hard to measure, or even unmeasurable.

**The three musketeers**

Preparing for predictable change might be difficult, but at least it is actionable. More concerning is learning how to anticipate unexpected change. To do this, we need to develop three attributes.

The first is to develop peripheral vision and be aware of what is going on. We can do this by being connected – both externally and internally. This will allow us to understand our clients’ expectations, our competitive challenges, industry trends, new technologies and business models. If we can expand this peripheral vision beyond our industry, then so much the better.

The second attribute we need to develop is the ability to think. Of course, we can all think, but we have to make time for it. Is it not curious how often people say that a thought came to them in the shower, or maybe while walking the dog? These are some of the few times in the day when we are not receiving information. We have to unplug ourselves to make time to think. That is when we might become curious about a weak, but possibly important, signal, or when we realise the truth lurking behind some data.

Third, and finally, we have to be brave. We do not always have to fall in with the prevailing view. Sometimes, we need to trust our instincts. In business, we often have incomplete or ambiguous information. So we have to find the courage to act and behave like an entrepreneur.

If we can be aware, give ourselves time to think and sometimes have courage, then we will anticipate even unexpected change and propel our businesses forward in a changing world.

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**Alan Cameron believes we need to learn how to anticipate the unexpected**

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### (Un)anticipated change

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Q: How does a relationship develop to become a partnership?

There are several key criteria needed for a successful partnership that will stand the test of time and be mutually beneficial. Most importantly, there has to be a sense that the firm you are working with actually wants to partner. It has to believe that that’s the right way to do business.

When I think of partnership journeys that I’ve been involved in at BlackRock, they all have pivotal moments when a relationship moves from what I call ‘a thousand cups of coffee’, where you are getting to know each other, to one of extreme trust around a certain piece of business. That was exactly the case with our relationship with BNP Paribas. For us, it was when BNP Paribas Asset Management appointed Aladdin, our risk and analytics operations platform, to be the very spine of their business. This successful appointment created an atmosphere where BlackRock and BNP Paribas wanted to find multiple ways we could move forward. This eventually led to the securities servicing business that BNP Paribas is providing for our ETFs in Brazil.

That’s a great example of something that perhaps never would have happened had we not had the partnership in place. I’m excited about the relationship between the two firms going forward. Our firms have a shared belief in the meaning of partnership and how it can lead to better outcomes for our clients and our two organisations.

Q: How would you define the BlackRock and BNP Paribas partnership today?

A few years ago, I would say BlackRock and BNP Paribas had a good relationship, but it wasn’t a partnership. Both firms were working together on positioning our products inside the various distribution systems of BNP Paribas, and our capital markets businesses were working together on certain elements. However, what happened last year with the selection of our Aladdin platform was a real commitment at the top of both organisations to turn this relationship into something quite special – a real partnership. One of the great things about this partnership is that it has almost infinite headroom to grow. We have so much of what’s required to be successful in this partnership already.
ROBERT FAIRBAIRN SHARES THE CRITICAL FACTORS OF A SUCCESSFUL PARTNERSHIP

STEP BY STEP
It is important to keep in mind that small steps can lead to giant leaps. Carefully thinking about individual projects and executing them well is really going to build the bigger pie over time.

TRANSPARENCY
Both firms have to be clear and honest with each other. When a product and/or service may not be strong enough to support each other, we need to be transparent about the issue.

MEASURABLE
Measurable outcomes are incredibly important. Set goals and review how we have done against those goals.

ACCOUNTABILITY
For each work stream, there is one BlackRock leader and one BNP Paribas leader working together to drive the outcome.

RESPONSIBILITY
We have a responsibility around the partnership – to our shareholders, our employees and, most importantly, our clients. BNP Paribas’ commitment to sustainability very much chimes with everything that BlackRock is doing.

SENIOR MANAGEMENT ALIGNMENT
Without senior management alignment, you will never have a successful partnership. The rest of us can be ambitious and pursue individual lines of opportunity, but you are never going to have something special without buy-in from senior management.

"When I think of partnership journeys that I’ve been involved in at BlackRock, they all have pivotal moments when a relationship moves from what I call ‘a thousand cups of coffee’, where you are getting to know each other, to one of extreme trust around a certain piece of business”

ROBERT FAIRBAIRN, SENIOR MANAGING DIRECTOR, BLACKROCK

Robert Fairbairn oversees the Strategic Partner Programme, responsible for BlackRock’s largest client relationships, and the Strategic Product Management Group, responsible for the firm’s overall product strategy and product suite. Fairbairn is a member of the Global Executive Committee, Global Operating Committee and co-chairs the Human Capital Committee. He also serves as a board member for the BlackRock Equity-Bond and Equity-Liquidity mutual fund family.

Robert Fairbairn

Curriculum Vitae

"When I think of partnership journeys that I’ve been involved in at BlackRock, they all have pivotal moments when a relationship moves from what I call ‘a thousand cups of coffee’, where you are getting to know each other, to one of extreme trust around a certain piece of business”

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Robert Fairbairn

Curriculum Vitae
As in developed economies, investors across Latin America are turning to ETFs as a way of achieving asset-class diversity, say BlackRock’s Nicolas Gomez and BNP Paribas’ Jeffrey Baccash and Andrea Cattaneo.

Some 25 years after their US introduction, exchange traded funds (ETFs) continue to proliferate globally, with attributes including low fees, high liquidity, ease of use, full transparency and bona fide tax efficiency. Today, ETF products cover a growing range of investment strategies, from equity and fixed income to commodities, smart beta and real estate, as well as emerging segments, including both passive and active approaches.

Having first gained traction in the US and later across Europe, ETFs have expanded into emerging areas, including Latin America. A key catalyst is Brazil, where steady economic growth and a slew of regulatory reforms...
have helped pique investor interest. As capital once again flows into Brazil and neighbouring regions, a growing number of foreign investors are turning to highly liquid, low-cost ETFs as a way of boosting local allocations, while the relative safety and flexibility of ETFs have attracted participants within Latin America itself, particularly those seeking greater international exposures. According to Greenwich Associates, a market intelligence and advisory services firm for the financial services industry, 2017 saw a nearly two-fold jump in ETF adoption throughout the region, with strategies such as fixed income, real estate and commodities among the list of exchange traded gainers. Looking ahead, domestic pension plans and other asset managers in Brazil are expected to boost ETF adoption as a way of gaining access to the US and other key markets that may be otherwise off limits due to cross-border restrictions.

ETFs on the fast track Since the start of the decade, global ETFs have achieved an organic annualised growth rate of 19%, more than four times that of standard open-ended mutual funds. Going forward, a number of structural trends are likely to drive future ETF adoption. First, many managers have begun to shift their focus away from securities selection and more towards portfolio design/asset allocation in order to achieve maximum value. Next, changes within the fixed income market have helped further ETF growth. Because banks no longer consider bonds an efficient use of capital when cross-trading, bond market liquidity has been impacted, resulting in wider bid/offerspreads—upwards of 50–60 basis points (bps) across the high yield sector, for example. Compare this to iShares’ iBoxx $ High Yield Corporate Bond ETF, currently averaging around 1bps. Not surprisingly, managers are gravitating towards such products to reap the cost savings. Investors are also increasingly using ETFs as financial instruments, often in place of derivatives such as forwards and swaps, particularly for corporate bond and emerging market strategies. Long-term market structure shifts are accelerating the trend. As banks’ balance-sheet costs increased due to new capital and liquidity requirements, transacting hedged derivatives has become pricier (by as much as 30–40bps, in some instances). By contrast, an equivalent ETF derivative substitute can be had for a fraction of the cost (4bps, on average). While derivatives are still preferable for levered or short positions, ETFs have become the go-to option for long managers.

Additionally, the ongoing move from commission- to fee-based advisory services – driven in part by demands for greater transparency around investment products – bodes well for ETFs, particularly as managers seek lower-cost strategies that can support fee-based economics. At present, only about 3–4% of funds remain transactional, mainly to reach otherwise inaccessible portions of the global market.

Uptick in Latam Latam investors are turning to ETFs to achieve asset-class diversity across different geographies using a relatively safe, liquid instrument. Regional pension funds were among the first to look abroad for investment opportunities: it was the early 2000s and qualities like “low-cost” and “no counterparty risk” had yet to become the industry buzzwords of the post-crisis era. Following 2008, investors who had incurred significant losses resulting from opaque credit exposures were suddenly clamouring for liquidity, asset-class diversification and, above all, full transparency – attributes intrinsic to the ETF structure. Ultimately, Latam managers began to see ETFs as versatile, investor-friendly products for accessing global indexes, thereby providing clients with the all-important element of diversification. The success of these early ETF forays would subsequently compel other local asset managers and insurance firms to take the plunge.

Today, institutional ETF allocations continue to rise throughout the region, reaching 13% of all invested assets during 2017, according to Greenwich Associates – a nearly two-fold increase year-over-year. Mexico maintains front-runner status, with ETFs averaging roughly 40% of the country’s total share volume (compared with 25% in the US). Though utilisation in Brazil remains well behind, a similar quest for diversification, the result of an ongoing shift in local economic conditions, has begun to emerge in that country, and, accordingly, observers see ETF assets under management (AUM) in Brazil (currently estimated at around USD 2.5 billion) steadily rising over the near term.

Key to this evolution has been a slow but steady awareness that looking outside the region is no longer an option but a requirement. Not even a decade ago, the percentage of non-domestic allocations in the region was almost zero – today, that has improved to around 10%, which is lower than where it should be, but a step in the right direction.
Another argument in favour of ETF investing is preferable tax treatment. In Mexico, local investors using ETFs with foreign exposures pay a 10% withholding tax, compared with an average 30% tax on gains when trading individual foreign securities.

**Buy, buy Brazil**

Brazil began offering ETFs in 2004, and currently includes 15 listed exchange traded products, most of them equities-based (a first-ever fixed income ETF debuted in September 2018). Despite its relatively small size, the market has averaged some USD 50 million in daily volume, thanks in part to products ranging from repos and stock loans to futures and options, as well as the ability for investors to use ETFs as trade collateral. The majority of ETF owners are institutional clients, accounting for some 62% of exchange traded allocations according to stock exchange B3, with foreign investors representing just 7% of regional activity.

Like many in the region, Brazilian investors have historically favoured domestic securities, in particular high-interest bearing fixed-income products. Given the severe turbulence of the last few years— including a sustained drop in commodities pricing and subsequent equities sell-off—many are now taking a second look at international asset classes, and not just for their tax incentives. At present, regulations prohibit foreign funds from being distributed within Brazil; additionally, many regional banks and other financial companies lack the infrastructure to directly invest in foreign exchanges. Hence, listed Brazilian ETFs that trade in the local currency yet offer full international exposure remain the easiest—and least costly—route for globe-trotting investors. Accordingly, more regional managers are expected to offer ETFs in an effort to meet this growth in demand.

**ETF checklist**

When sizing up prospective ETFs, it is crucial that investors seek the most qualified providers possible, while also considering such criteria as fund liquidity, AUM, number/type of offerings as well as years of service in the field. For their part, providing adequate information can help managers ensure that investors choose a basket of securities that properly reflects their long-term objectives. Accordingly, going forward, education remains a priority for both passive and active fund managers, not only around foreign allocations, but also fixed-income strategies that have traditionally dominated Brazilian portfolios. As part of this effort, custodians and administrators continue to work with managers to provide support for institutional clients seeking increased ETF exposure.

For Brazil and other regional markets that have almost exclusively focused on local opportunities, the ability to gain global access through ETFs is a potentially game-changing development. Given the pronounced volatility that has roiled the regional markets over the last few years, it is perhaps no surprise that investors are finally looking to diversify their portfolios using different currencies, sectors and asset classes. And, as many are discovering, ETFs are often the most efficient way to make that happen.

Nicolas Gomez is Head of Latin America and Iberia iShares at BlackRock. Jeffrey Baccash is Global Head of ETF Solutions and Andrea Cattaneo is Head of Securities Services, Brazil at BNP Paribas.

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**We strive to be the premier global banking partner for ETFs**

BNP Paribas Securities Services has built its reputation as an ETF servicing agent in Europe for over a decade and is continuing to expand its offering to new regions as an integral part of its global asset servicing strategy. This experience, combined with the strength of a global integrated Corporate and Institutional Bank, uniquely positions BNP Paribas as one of the premier ETF servicing agents in the world.

- We currently service over 200 ETFs across a wide range of ETF strategies, including equities, fixed income, commodities and financial derivatives investments.
- Our ETF clients have funds registered in five different domiciles across Asia, Europe and the Americas.
- We have the ability to facilitate passporting capabilities for single ETFs with multiple exchanges across Europe.
- In addition to dedicated ETF Operations, we provide ETFs with Accounting, Administration, Custody, Transfer Agency, Depo Bank and Securities Lending services.
- BNP Paribas’ Global Markets desk is a recognised industry leader as an ETF Market Maker, Authorised Participant and Swap Counterparty.

BNP Paribas is committed to investing in our people, processes and technology to support the ETF industry. Through our experience and market research, we believe there are opportunities to innovate and address the inefficiencies that exist in various parts of the ETF ecosystem. Utilising our digital and innovation centres, we are co-creating solutions with top ETF issuers to provide a best-in-class, global client service model for this rapidly growing asset class. This digital and innovation initiative includes the development of a ‘next generation’ ETF servicing platform.

For more information on our ETF Services, please contact your BNP Paribas relationship manager.
The asset management sector is rapidly changing under the influence of regulation, evolving end investors’ behaviours, new technology and the emergence of new business models. Arnaud Claudon, Head of Asset Managers at BNP Paribas Securities Services, looks at how the business is positioning itself to support the sector in this transforming landscape.

The decisions that asset management companies are making today will help to determine the shape of the industry in the future and are likely to have profound consequences in the years ahead. From our perspective, there are four key structural consequences: the continued growth in outsourcing of non-core processes; the search for greater end-to-end efficiencies; the consolidation among industry players; and the changing nature of the relationship between asset managers and their banking partners.

Arnaud Claudon

Claudon is Head of Asset Managers at BNP Paribas Securities Services. He is responsible for strategy, product development, client solutions and P&L management for the asset manager segment. Prior to this, Claudon was Global Head of Depositary & Fiduciary Services.
Asset managers are familiar with the concept of outsourcing because their entire business model consists in managing money on behalf of asset owners. They’ve long applied the industrial logic of outsourcing to themselves by sub-delegating the management of non-core investment strategies, or the operations of their back-office and increasingly middle-office functions. Middle-office functions are a fertile area given the complexity and cost of running post-trade and multi-asset investment operations.

Over the past few quarters, we’ve seen an acceleration of outsourcing decisions. Some large institutions that had kept as much as possible of their operations in-house have reached a tipping point and decided to switch to outsourcing. Activities such as collateral management, passive currency overlay, loan administration and private equity fund administration are now increasingly seen as viable and urgent areas to source.

BNP Paribas Securities Services has considerable experience in both back- and middle-office outsourcing and we continue to build up our presence in this area, with several major deals announced in 2018. In April, Janus Henderson Investors completed the lift-out of its US middle- and back-office operations to us. In April 2017, Dutch asset manager ACTIAM appointed us to run its front, middle- and back-office asset management operations.

Other deals are also in the pipeline. We are currently working with a large pan-Asian institution to complete the outsourcing of their full middle-office operations across Asia-Pacific – a sign that institutions see real value in optimising their post-trade operations, notably when facing complexity and a need for scalability.

Of course, outsourcing is often complex, particularly when dealing with multi-market, multi-asset operations. It is a disruptive process and doing it well takes time, but the debate these days is not so much whether to outsource non-core processes or not, but how to do it with as little disruption as possible. A critical factor is the readiness of the asset manager to outsource and whether it is clear about what it wants to retain, what it is ready to relinquish and whether it is ready to embrace the new operating model that will result from the outsourcing. In fact, in our experience, aligning the organisation so it is ready for outsourcing can be more time-consuming than the actual process of executing the outsourcing itself.

Even then, execution comes with a risk and to mitigate that risk – experience matters. Every situation is unique, but it is helpful to have successfully worked through complex cases in the past, as BNP Paribas Securities Services has done across Asia-Pacific, Europe and the US.

The underlying aim of all this outsourcing activity is to improve the efficiency of an organisation so it can focus on what it does best, which takes us to our second major trend.

We are in an industry where margins are still sizeable, but they are under pressure and shrinking fast. Removing unnecessary costs and frictions in the processes is one way of mitigating that pressure.

There is plenty of potential here, given that the process of managing funds and distributing investment products often has a lot of inefficiencies. Data is an area of concern, especially when you have lots of stakeholders maintaining different versions of records that ultimately need to be reconciled. Every time data sets are inconsistent and incomplete along a disjointed workflow, or records need to be duplicated and reconciled, frictional costs are incurred and add up to material amounts. In this context, the ‘holy grail’ can take the shape of single, integrated, enterprise-wide front-to-back data models or shared ledgers of investor records, for instance. In practice, such solutions need to pass the reality test of data protection, local market practices and regulations, as well as co-existence with legacy systems.

However, there are new technologies that can reduce the amount of friction. Distributed ledger technology, such as blockchain, can ensure all parties view the same data, which means there is no need for a lengthy or complex reconciliation. There are also ways to generate efficiencies by improving the reconciliation process itself – applying artificial intelligence and machine learning can identify the root cause of discrepancies and sometimes even anticipate problems before they occur. A further way of addressing inefficiencies is to improve the way data is managed, so that the sophistication of management of data is proportionate to the importance of data in the organisation.

We are investing heavily in this area, deploying digital workflows, artificial intelligence and programs that automate manual processes. We also deploy predictive algorithms to identify potential issues before they happen; for example, our Smart Chaser initiative, being rolled out, will identify the trades most likely to fail before they occur. We are also designing data aggregation, consolidation, orchestration and delivery solutions.

One has to be realistic about such technologies. We are not waiting for a single system that will provide a perfect solution to all the challenges, but we are proactively investing in technology to introduce better processes and to improve legacy processes and make them more efficient. At the end of the day, it is the asset managers’ end clients who will benefit from this because it reduces costs and increases value.

As all this indicates, the smart use of technology is key to making improvements in end-to-end efficiency. We also have to embed new skills and knowledge into our organisation and we look to fintech firms and other external specialists to help us do that. Beyond the benefit of ensuring that our own processes are as efficient as they can be, we also share our experiences of digital transformation with our clients. There are often lessons we can learn from each other about how to use technology to work in more agile ways.

Wherever needed, we collaborate with industry associations, partners, competitors and regulators to agree common standards. In all these areas, every day, thanks to our scale and investments, we make progress to improve efficiency and restitute value to our clients and their end clients.
Efficiency gains and critical size are key drivers behind another major trend in the industry: merger and acquisition activity. A key factor behind much of the ongoing consolidation activity is the desire for asset class diversification and fund range rationalisation. Merging two organisations is a way to close gaps in their respective product portfolios or geographic footprints relatively quickly. These are often large, complex deals involving many different asset classes, multiple geographies and, of course, different corporate cultures. We have been at the heart of the recent wave of such deals, including the merger between Standard Life and Aberdeen Asset Management in 2017. We also helped Japan’s Nikko Asset Management when it acquired DBS Asset Management in Singapore and Tyndall Investments in Australia and New Zealand, assisting it with integrating them into its existing structure and enhancing its operating model accordingly. We have a long heritage in this area. Other deals we’ve been involved with in the past include acquisitions by Aberdeen Asset Management of parts of Deutsche Bank Asset Management in 2005 and Credit Suisse Asset Management in 2008, the integration of Gartmore into Henderson at the time, the acquisition of AXA Asia Pacific by AMP in Australia in 2011 or facilitating the merger between BNP Paribas Investment Partners and Fortis Investment Management in 2010. We delivered the share of the synergies that we had committed to, which allowed those deals to be extremely successful.

It is important that such deals fully deliver on their potential. They are complex choreographies that need to be executed well. It is important not to underestimate the scale of the task, as mistakes in understanding business requirements, target operating model design and overall execution can lead to differences in cost and the timeframe of executing a deal.

As a post-trade specialist, we know how to fit in with the deal timelines. We can contribute to the synergy estimate and suggest the most relevant operating models. And as these deals often involve an element of lift out of some back- and middle-office teams, we can help by delivering post-trade services to the newly enlarged institution.

We are also involved in industry consolidation in its own right, being one of the most active acquirers of depositary banks in Europe. A lot of banks have been looking to exit from fund depositary banking activities as the regulation and complexity in this area has increased, along with the costs. We have been acquiring a number of these businesses and integrating them very successfully into our own operations.

In tandem with the changes taking place within the asset management industry, there are also changes happening in terms of approaches to banking services. Asset managers are increasingly moving from a pick and choose approach to a more holistic view of their banking relationships. It is no longer sufficient to be good at just one particular product or service. Large asset managers are choosing banking partners very carefully based on their ability to contribute materially to the sustainable success of their strategic goals, through good and bad times.

Instead of being able to focus on individual products, for banks these days it is also the ability to offer seamless integration across the entire range of services – including asset safety, intraday and overnight facilities, capital financing, acquisition financing and other products – that is deemed important. That doesn’t mean the performance of each individual product doesn’t matter – each service still has to be competitive – but it does mean clients recognise the value of a strong ecosystem of integrated services at a global scale.

As with all the changes happening in the industry these days, it is the ability to recognise important trends and adapt to the changing needs of clients which helps determine success.

Done deals

BNP Paribas Securities Services has been involved in some of the biggest mergers and acquisitions in the asset management industry during the past 15 years:

2005: Aberdeen Asset Management and Deutsche Bank Asset Management
2008: Aberdeen Asset Management and Credit Suisse Asset Management
2010: BNP Paribas Investment Partners and Fortis Investment Management
2010: Nikko Asset Management and Tyndall Investments
2011: Henderson Group and Gartmore
2011: Nikko Asset Management and DBS Asset Management
2011: AMP and AXA Asia Pacific
2017: Henderson Group and Janus Capital Group
2017: Aberdeen Asset Management and Standard Life
TIMES THEY ARE A CHANGIN'

As the financial services sector remembers and reflects on the 2008 financial crisis, we chart the major milestones on its road to recovery since the surprise collapse of Lehman Brothers.

**September**
After a year of growing crisis triggered by defaults on sub-prime housing loans in America, US authorities allow Lehman Brothers to fail.

**October**
Co-ordinated international attempts are made to ease panic. US President George Bush signs the Troubled Asset Relief Program, allowing authorities to buy up to USD 700 billion worth of financial assets.

Many banks are undercapitalised, some leveraged over 50 times. Regulators will later characterise the regulatory frameworks at the time of the crash as ‘light touch and ineffective’ and the markets as ‘fragile and unfair’, with few participants exposed to the long-term consequences of their actions.

**November**
The US Federal Reserve begins quantitative easing. The Bank of England soon also adopts this unorthodox expansionary monetary policy, designed to increase growth and liquidity.

G20 leaders commit to radically reforming the system and creating resilient banks, ensuring no bank is ‘too big to fail’, transforming shadow banking into market-based finance and making the derivatives market safer.

**December**
After a year of recession, US economic growth falls to -0.8%. The US slashes interest rates to 0.25% (from 4.25% a year before).

**March**
The FTSE 100 share index falls by nearly half to 3,530.

**April**
Eurozone ministers order France, Ireland and Spain to slash their budget deficits at the start of the eurozone crisis.

**September**
G20 leaders, meeting in Pittsburgh, US, agree to standardise OTC derivatives contracts traded on exchanges or electronic trading platforms and cleared through central counterparties. Contracts are to be reported to trade repositories and non-centrally cleared contracts subject to higher capital requirements.

**October**
The Basel Committee on Banking Supervision publishes the first version of Basel III, designed to improve regulation, supervision and risk management in the banking sector.

**December**
USD 15 trillion of public money is directed so far on bailouts, government guarantees of bank liabilities and special central bank liquidity schemes.

**March**
The Foreign Account Tax Compliance Act (FATCA) becomes US law. Aimed at preventing tax evasion by US investors (who are liable to pay US taxes irrespective of their domicile), FATCA requires foreign financial institutions to provide US tax authorities with details of American account holders’ dealings or face a penalty tax for non-compliance. The regulation is due to come into force in July 2014, with penalties to be imposed from 2019.

**July**
US President Barack Obama signs the Dodd–Frank Act. A high point in legislative moves designed to curb banks, it establishes a number of new government agencies to monitor the financial stability of major firms. The law creates the designation of ‘systemically important financial institutions’ (SIFIs) for the big banks that are deemed to be ‘too big to fail’. These institutions are subject to increased regulatory requirements and scrutiny, including strict oversight by the Federal Reserve, higher capital requirements, periodic stress tests and the need to produce ‘living wills’ (plans to wind up operations without triggering a financial crisis or requiring a bailout). The Act improves support for whistleblowers. Also included is the so-called ‘Volcker Rule’, which proposes banning many forms of short-term trading by banks with assets of more than USD 50 billion to reduce risk to taxpayers and the world economy. The Volcker regulation finally takes effect in 2015.

**July**
Basel III reforms are agreed for implementation from 2015 to 2018.

**September**
At an International Monetary Fund (IMF) meeting, the world’s financial institutions declare they are staring into ‘the abyss’.
June
The EU publishes the revised Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR), aimed at strengthening investor protection and improving the functioning of financial markets, making them more efficient, resilient and transparent.

July
The US adopts revised Securities and Exchange Commission rules on Money Market Funds (MMFs). MMFs are an important source of short-term financing for financial institutions, corporates and governments and were made a priority area by the Financial Stability Board in 2012 in relation to the shadow banking system.

August
The EU publishes its Central Securities Depositories Regulation (CSDR). Its objective is to introduce a European regime covering European Central Securities Depositories (CSDs), rather as central counterparties and trading venues and investment firms will be covered by other EU rules. CSDR provides rules on issues such as the authorisation, supervision and passporting of CSDs, as well as minimum organisational requirements for them.

September
The G20 major economies agree to develop a global variant of the US FATCA tax regulations. Called Automatic Exchange of Information (AEOI), it establishes common rules for the reporting of client assets and income to local tax authorities in order to prevent tax evasion. Unlike FATCA, no withholding tax is applied. In those jurisdictions that have committed to 2018 implementation, financial institutions must begin first reporting to the local tax authority by March 2018.

November
A Financial Stability Board report expresses concern at the continued growth of shadow banking, a largely unregulated sector that has grown globally to USD 75 trillion in 2013.
March
The UK’s Financial Conduct Authority introduces its Senior Managers and Certification Regime, forcing banks to explain who can be held responsible for each activity within a bank. Australia and Hong Kong will later adopt a similar approach.

The EU introduces the UCITS V Directive, to focus on increasing investor protection for UCITS (Undertakings for Collective Investment in Transferable Securities) funds, which are sold to the general public.

June
A majority of the UK population votes to leave the EU.

August
The Financial Industry Regulatory Authority (FINRA) announces changes to its Rule 4210 that would require its members that engage in covered agency transactions with counterparties to make and enforce written risk determinations for each counterparty.

November
The EU publishes proposals on Central Counterparty Recovery and Resolution Regulation. It sees central counterparties as the new ‘too big to fail’ issue and wants the powers to step in when a central counterparty fails or faces a threat such as a cyber attack. Central counterparties are required to draw up recovery plans for such events.

April
Bank of England governor Mark Carney declares that the capital requirement for the largest banks is ten times higher than a decade ago and that banks have raised more than USD 1.5 trillion. He states that the financial system is simpler and banks are less complex. Business strategies that relied on high leverage, risky trading activities and wholesale funding are disappearing, ‘as intended’. Off-balance-sheet vehicles have been curbed and the fragile forms of shadow banking eliminated.

May
The EU publishes its European Market Infrastructure Regulation (EMIR) review proposal. It aims to improve the functioning of the derivatives market in the EU and provide simpler and more proportionate rules for over-the-counter (OTC) derivatives. Among EMIR’s aims is to reduce systemic risk and increase transparency in the OTC markets. All financial counterparties, including banks, brokers, asset managers and insurers, and certain non-financial counterparties, consisting mainly of corporates, are covered.

June
The US Financial Choice Act becomes law allowing for the roll-back of some provisions of the Dodd–Frank Act, including the Volcker Rule. This signals the end of the regulatory drive to constrain banks in the US.

The EC publishes regulation on MMFs. A key objective is to prevent the risk of contagion potentially transmitted by the ‘run’ of MMFs to money markets and to their sponsors (mainly financial institutions). Among the new measures are new risk management requirements, which impose stress testing and internal processes to determine credit quality for money market instruments, and ‘Know Your Customer’ policies and procedures.

January
MiFID II/MiFIR comes into force after delay. Among the new rules are reporting requirements designed to reduce the use of so-called ‘dark pools’ and over-the-counter trading. High-frequency trading faces a strict set of organisational requirements on investment firms and there is an extension of existing rules to structured deposits.

March
An IMF paper shows that the scale of off-balance-sheet funding within banks is actually higher now than at any time since the crisis, despite the overall shrinkage in bank balance sheets.

April
FINRA delays implementation of its Rule 4210 changes on risk determination for each counterparty until March 2019.

May
President Trump signs into law regulations reducing the Dodd–Frank Act’s oversight of banks to those with assets below USD 250 billion rather than the previous USD 50 billion. Many of the tough standards remain intact but the number of US banks deemed to be ‘systemically important’, and therefore covered by the rule, falls to around ten.

June
US interest rates climb to 2%.

September
On the Lehman anniversary, IMF managing director Christine Lagarde tweets: “We have come a long way, but not far enough. The system is safer, but not safe enough. Growth has rebounded, but is not shared enough.”

January
The UK Banking Reform Act 2013 comes into effect, ring-fencing retail banking from investment banking to safeguard customers.

March
Basel III regulations on banks to be fully implemented. The UK is due to cease to be a member of the EU.
SUSTAINABLE INNOVATION IS IN THE AIR

Airbus is taking a bold approach to innovation that builds on emerging technologies.

Few industries, apart from aviation, have been makers of dreams so consistently over the past 115 years since Orville and Wilbur Wright flew their inaugural plane in a cold North Carolina December. What legendary aviators like the Wright brothers could not have foreseen was the industry’s reach by 2018.

As the underlying demand continues to grow fast, driven by the ever-increasing affordability of air travel, enabled by new engineering prowess and new technologies, the air transportation industry has experienced above-average growth rates in the past few years. By 2016, commercial airlines globally flew 3.8 billion people.
“The EU is very committed to the environment and fighting climate change, so together with 200 countries, in 2015, we signed the Paris Agreement”

Tiit Jürimäe, Executive Director, Clean Sky

Support from the EU
The European Union (EU) is supporting these efforts via a public-private partnership between the European Commission and the European aeronautics industry, called Clean Sky. This partnership aims to create breakthrough technologies to significantly increase the environmental performance of aircraft.

Tiit Jürimäe, Executive Director of Clean Sky, says: “The EU is very committed to the environment and fighting climate change, so together with 200 countries, in 2015, we signed the Paris Agreement. And now, we are working with them on their ambitious implementation measures. And one aspect of that is also reducing carbon emissions in transport and aviation.

“The objective for transport is to reduce emissions by 40% by 2030, leading to more than 80% reductions by 2050. This could help us to reach the Paris Agreement goals to limit global warming by two degrees, or even by 1.5 degrees by 2050.”

A corporate commitment
It’s a strong ambition, set by the industry and driven by the leaders of the sector, including Airbus – the largest maker of commercial aircraft in the world and a critical technology and defence player in the EU.

From its origins as a pan-European government-led project in the 1970s, the company has grown through multiple transformations into one of the most systemically important companies in Europe, and in the world, over the past ten years.

One of the strong commitments made by Airbus was a renewed focus on responsibility and sustainability (R&S) in the digital age. This commitment is being...
As the air transportation industry grows in size, it has realised the need to address its role in tackling climate change, despite representing only 2% of global man-made CO₂ emissions demonstrated through a full R&S charter spelling out clear commitments, and through initiatives supporting the United Nations (UN) Sustainable Development Goals (SDGs).

As a member of Clean Sky, Airbus is committed to contributing to the UN SDGs by investing in research and technology to accelerate the development of groundbreaking solutions and by partnering with other players to meet the long-term, global environmental targets set by the UN (for more on the UN SDGs, see page 36).

**Pillar of sustainability**

Sustainability is one of the key pillars of Airbus’ Environmental Social Governance strategy and it is at the heart of many of the firm’s innovation and research projects for the future (see Pioneering Technologies, right).

Today, Airbus is leading fuel efficiency league tables for regional flights of 500–660 nautical miles (930–1,220km). In particular, the aircraft are leaders in fuel efficiency on short-haul flights of 1,000 nautical miles (1,900km). On a par with its peers, Airbus carriers show good efficiency on the long-haul flights.

The growing A350 XWB fleet is an example of Airbus' new generation of eco-efficient planes. Both variants – the A350-900 and its longer twin, the A350-1000 – cut fuel burn and emissions by 25% compared with previous generation wide-body aircraft. But the future will uncover even bigger revolutions brought by Airbus’ R&D efforts.

Airbus’ history in uniting people across Europe in a unique manufacturing system, which has now extended to assembly lines in three continents, has helped the company to be in a position today where it can take a lead in shaping the future of flight for a better connected and more sustainable world.

**Aviation future**

The aviation industry is heading to the future by extensively investing in sustainable disruptive technology. As one of the leaders in the sector, Airbus is paving the way for eco-friendly global transport networks and innovations tackling climate change. There is a long way to go, but the transition is happening now. The pace of this transformation will surely be exceeding the speed of sound not even 100 years after Chuck Yeager exceeded it for the first time in level flight. 

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**PIONEERING TECHNOLOGIES**

Airbus takes a bold approach to innovation, building on emerging technologies while investing in other forward-looking start-ups across industries:

**E-Fan X:** Airbus, Rolls-Royce and Siemens have formed a partnership that aims to develop a near-term flight demonstrator, which will be a significant step forward in hybrid-electric propulsion for commercial aircraft.

**Vahana:** This is a project aimed at advancing electric, self-piloted VTOL (Vertical Take-Off and Landing) flight.

**Skyways:** In February 2018, Airbus’ parcel delivery drone successfully completed its first flight demonstration in Singapore. Prototyping for the Quadcruser – a scalable, unmanned aerial vehicle that combines hover capabilities with the cruising speed of an aircraft – to deliver heavier loads such as medical supplies is also under way.

**CityAirbus:** This multi-passenger vehicle, which uses self-piloting, VTOL and electric propulsion technology, had a first flight planned for the end of 2018.

**Voom:** Airbus has partnered with Audi to develop this on-demand helicopter platform, which will deliver an end-to-end, seamless transportation service, starting in São Paulo and Mexico City.

**BLADE (Breakthrough Laminar Aircraft Demonstrator in Europe):** A collaboration with large-scale industrial partners in Europe and supported by the Clean Sky programme, BLADE launched its first flight based on an experimental technological design aimed at testing in real conditions a new type of wing that can generate up to 50% less friction.
GIVING INNOVATION A BOOST

Established financial services firms and their clients can benefit hugely from joining forces with fintechs, as BNP Paribas Securities Services’ partnership with Fortia Financial Solutions has proved.
Technology has always been an important part of the financial sector, but it has increasingly become a disruptive force, changing mainstream finance in radically transformative ways – a trend we’ve all come to know as ‘fintech’.

Last year saw a rise in incumbent financial firms allocating resources to research and development in fintech. Many such firms believe they risk getting left behind in the financial markets of the future if they do not explore this trend. Incumbents’ investment into the sector has seen acquisitions of challenger start-ups as well as the in-house development of such firms.

Leading the way
BNP Paribas Securities Services has been at the forefront of these developments with its in-house fintech sandbox, launching its own start-ups or partnering with existing start-ups outside the firm. In 2017, the business took a minority stake in fintech start-up Fortia Financial Solutions, a software company that uses artificial intelligence, machine learning and business process monitoring to help the fund industry meet rising compliance requirements and manage volumes of data.

Jean Devambez, Chief Catalyst at BNP Paribas Securities Services’ Digital Transformation Lab, is responsible for spotting and launching new in-house ideas that can be converted into start-ups. He also looks for opportunities to collaborate with existing start-ups to solve an in-house problem where the business does not have the requisite expertise, but has other resources to help the start-up scale up. To work successfully with existing start-ups, he says finding a good issue to solve is crucial because the effort involved in scaling up will be quite significant. “This was the case with Fortia,” he adds.

When BNP Paribas Securities Services took a minority stake in Fortia two years ago, the fintech firm had five staff members. They are now close to 70 employees, mainly because they had to scale up to enable BNP Paribas Securities Services to work with their platform. Devambez says: “From a commercial standpoint, Fortia is successful because the product is good, but our name and brand in the partnership has also helped it grow. We bring this capacity to accelerate growth, and also the expertise.” BNP Paribas Securities Services also helped Fortia to deliver all the non-functional requirements that the bank requires, such as security and compliance to deliver the products to the industry at the required standard.

People and process
The most important element in partnerships with start-ups is people, says Devambez. “You need to have experts who you can trust because you don’t really have much more than that when you begin the project. With Fortia we were absolutely convinced by the product, but looking back at the effort they have made from where they were to where they are today, it is all about people and how they are able to attract additional talent and to manage →
Fintech’s potential in asset servicing and management

In asset servicing and management, the technologies that promise the most potential are artificial intelligence (AI), especially natural language processing (NLP). BNP Paribas Securities Services’ Jean Devambez says the intuition for this is obvious: “We are in an industry still using a lot of paper and manual processes. There are many areas where smart automation can deliver short-term benefit for quality, efficiency and cost.”

Boston Consulting Group’s 2016 report Fintech in Capital Markets: A Land of Opportunity found that asset managers and custodians have been slower than banks to adopt fintech. Fortia’s Sira Ferradans thinks this might be because it is more difficult to automate an asset manager because many written and spoken texts and opinions are used in the industry. Meanwhile, the technology in more complex and creative natural language generation is not as advanced as natural language understanding.

Ferradans predicts more activity in applications of text generation, which will help asset managers and custodians get into the deep learning wave and machine learning wave. Major trends will continue to be companies trying to find applications for machine learning in the financial domain, for example, with robo advisers and aspects of NLP not completely exploited.

Fortia uses AI and machine learning to manage compliance, data, risk and depositary reporting and is also working with several financial institutions to automate their data management processes. Generation and analysis of compliance documents can be very time-consuming and involve many different departments and people and validation of information already in a database, but without a common platform on which participants can actively collaborate. Many internal databases of banks’ information can also have errors or be out of date.

What Fortia is proposing means the prospectuses can automatically be validated and based on texts already approved by lawyers, making it much faster to read. The technology uses classic machine learning to classify sentences by highlighting and extracting regulatory rules from prospectuses for every sentence in the document.

These applications also work for custodianship because the rules mandated by the asset manager in the prospectus need to be constantly validated against the portfolio. When the machines check the rules using mathematical formulae, they can help keep portfolios correctly balanced. Depositary reporting can also be similarly controlled every day to monitor breaches.

Another issue that a lot of big firms moving into fintech partnerships need to consider – an issue that venture capital firms, which have traditionally seeded such firms, understand well – is allowing room for failure. Some of the projects simply will not work or simply aren’t scalable.

Devambez agrees that incumbents must be open to experimentation, and also, failure, even if only to a limited degree. His process uses a three-to-six-month timeframe for ideas. When working with a start-up, this phase will allow both partners to identify a use case, perform detailed assessments of the product and qualify its fit with the market (does it answer clients’ needs, for example) and the organisation. By the end of six months, incumbents are basically committed and often in the same boat as the start-up. Also, by then, failure has too many consequences.

Dialogue is key

In collaborations between incumbents and start-ups, dialogue is key. Sira Ferradans, Chief Research Scientist at Fortia, says: “It is difficult for someone in tech to come up with solutions for a bank and vice versa. Things are not so obvious – especially technical terminology. You can decide what the final picture looks like together. It is a very creative process.”

Fortia definitely had the technological know-how at the start of the process, but Ferradans says it was eye-opening how some problems that are easy to solve for start-ups can be considerably larger for big firms. However, despite the complexity, Ferradans says “this relationship with a big company and a start-up entity that has a lot of experience in the domain can be very enriching”. While Fortia’s experience with BNP Paribas Securities Services was very positive, she can also see how start-ups can trip up and how
incumbents can suffocate innovation instead of supporting it.

Ferradans’ advice to big companies is to really think about what start-ups need. She says: “I think the first thing is to have people prepared to work on a completely different philosophy and flexible protocols because big institutions can be bureaucratic and this could cause big problems [in conflicting working styles].”

In fact, she thinks both sides need to be really clear about their own needs and consider the needs of the other party and give them space to achieve putting those protocols in place.

**What’s in it for clients?**

In the end, it is clients and the industry that should benefit from these partnerships and their mutual learning.

Devambez makes it clear that clients often ask for things they would like to see and use. He says: “Clients love that every time we present our approach to them, they can see we are investing in the future and bring them the possibility of new business through new services.”

Through better use of fintech, BNP Paribas Securities Services aims to address services not covered or well covered and increase the quality of end-to-end processing to deliver transparency and capacity and the ability to react more quickly to client needs. Efficient responses and faster access to information is a big plus as it ultimately improves the user experience. Data security is also ensured as the data used in the prospectus is publicly available and all the customer information stays inside the bank.

Overall, Ferradans sees the fintech sector developing positively as a result of these partnerships, as does Devambez. However, he cautions that incumbents need to distinguish between genuine structural innovation and marketing.

The introduction of a fintech partnership should be done for a good commercial reason and not merely to seem ‘on trend’ with the rest of the market.

“Having said that, I had a strong conviction, which is even stronger today, that it will remain difficult for banks to innovate 100% in-house for so many reasons. Sure, you can do a lot of things in-house, but for some cases it is very difficult.”

One obstacle to in-house innovation is the fact that incumbents are often under pressure to prioritise essential or compulsory projects, such as implementing regulatory change, dealing with platform obsolescence or driving through projects that achieve cost synergies.

There is still opportunity to collaborate if the partnership can’t be done in-house, by excavating some fintech start-ups and leveraging their capacity to achieve genuine structural innovation outside the company. “Again, that requires either collaborating with an existing start-up or creating and launching a new start-up,” says Devambez. The benefits of collaboration are worth the effort, he adds.

“Working with a start-up helps to evolve an incumbent’s mindset, bring fresh and more daring ideas to the table and highlight areas – such as decision-making – where incumbents need to improve.”

JEAN DEVAMBEZ, BNP PARIBAS SECURITIES SERVICES
Since establishing fintech company 10x Banking in 2016, former Barclays CEO Antony Jenkins has been urging financial services leaders to engage with the technology revolution sweeping across the sector. Here, he shares his thoughts on how fintech is affecting asset management and how asset managers should respond.

TECHNOLOGY IS AN OPPORTUNITY, BUT ONLY FOR THOSE WHO KNOW HOW TO GRASP IT
Much has changed in financial services since the 2008 crash. Regulators have significantly bolstered capital and liquidity requirements and set much higher conduct bars. Advances in technology and ready venture funding are enabling a new breed of digital-only providers to proliferate, chipping away at incumbents’ dominance. And the expectations of customers, who are seeing better, cheaper, faster and more transparent services in other areas of their lives, are only growing.

Asset management is no exception to these trends, as the rise of digital investment platforms well attests. But the changes afoot should not be dismissed as simply exchange traded funds for retail investors that are packaged in glossy smartphone apps.

Think of technological change as an iceberg. While it is easy to get distracted by the front-end use cases that float above the surface, such as app-only banks, the real scale and power of technological change lies hidden from view.

**Computers are getting more powerful**
Computers are still becoming exponentially more powerful at ever lower cost. Where Apollo 11’s guidance computer took man to the moon with 12,300 transistors, the iPhone XS has 6.9 billion.

The pace of that growth, and the computing capabilities that it can support, mean you can do things today that simply weren’t possible five years ago.

Cloud computing and machine learning are allowing big tech companies to glean a far sharper insight into people’s financial health than their own banks have; smartphones allow people to manage their entire financial lives in a single app; automated risk profiling and allocation of customers to portfolio types allows retail investors to invest in market movements, bypassing costly wealth management services that do not consistently deliver alpha.

These are next-generation financial services capabilities. But they also illustrate how many of the incumbents’ advantages of scale could be affected in the process. Why bother with the expense of discretionary asset management, or the poor service of a traditional retail bank, if a digital-only service promises to be significantly cheaper, quicker, more transparent and more effective?

**So, what can asset managers do?**
In my 36 years in financial services, one fact has stuck out. People only adapt to new technologies or processes when they are significantly better than what is currently available. Changing habits takes effort – so the payoff has to be worth the trouble.

Financial services are now at that inflection point. The dramatic increase in consumers’ adoption of mobile banking has led to a collapse in visits to bank branches. Back in November 2015, I predicted that this would lead to the closure of up to half of branches in the UK over a decade. I now believe that was an underestimate. If digital wealth management services can convince wealthy customers they are a safe, secure and convenient way to increase their returns with greater transparency at a fraction of the cost, we could see a shift in customer behaviour as drastic as the ones that have brought down big names in the past.

Much as customers avoid changing their habits unless new
ways are significantly better, so too do large businesses avoid changing their business models unless they feel truly compelled. Naturally, new technology feels riskier than well-established systems. But the real risk lies in getting left behind. As economist Joshua Gans argues in his book, *The Disruption Dilemma*, it wasn’t that companies that no longer exist found out later than everyone else what the future would look like. In fact, they knew earlier. They were unable to translate that insight into success.

Capitalising on innovation is about more than technology alone. Ultimately, it’s about people – how technology can help meet their needs as customers, and how to change your organisation to turn those technologies into profitable lines of business.

Financial services are all about data. Sophisticated data processing technologies – artificial intelligence and distributed ledgers, supported by cloud computing – will lead to significant improvements in the industry. They will enable smarter fundamental analysis to strengthen portfolios and better assessments of exposure and risk factors, such as foreign exchange, market volatility, settlement and reconciliation.

**Use people to add value**

However, these technologies will lead to the automation of many routine financial services tasks. Whether that frees people up to add value in other ways depends on whether your organisation can make the most of its human capital, and how well it is able to mix complementary human and machine skills. Technology alone cannot replace an investment thesis – yet.

The increased use of machine labour and the impact of greater competition from digital services will cause reassessments of how people add value to their organisations, and how organisations add value to their customers. The days of discretionary managers earning large sums are likely numbered.

The criticism that money managers are too slow to adapt to changing technologies is hardly new. But familiarity should not breed complacency or scepticism. Only those who are able to seize the opportunities technological change presents will be the winners.

**“As economist Joshua Gans argues, it wasn’t that companies that no longer exist found out later than everyone else what the future would look like. In fact, they knew earlier. They were unable to translate that insight into success”**

But the views of third parties set out in this article are not necessarily the views of the global BNP Paribas organisation.

![Cloud computing will lead to significant improvements](image)

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**Antony Jenkins**

Antony Jenkins is Founder and Executive Chairman of 10x Banking, which aims to redefine how banks operate and engage with consumers in the digital age.

Jenkins' focus on driving innovation in the digital economy also extends to his role as Group Chairman of Currencies Direct, the UK non-bank provider of foreign exchange and international payment services, and his role as a board member of Blockchain, the software platform for digital assets. He is a Board Director of Fannie Mae, sitting on the US mortgage lender’s Strategic Initiatives and Technology Committee and the Nominating and Corporate Governance Committee. He is also a member of the Consultative Working Group of the European Securities and Markets Authority.

Jenkins is a strong believer in the need for businesses to support the future workforce to acquire the right skills to thrive in the digital era. His commitment to education is recognised in his role as Chair of the Institute for Apprenticeships, an employer-led organisation established to promote high-quality apprenticeships by 2020.

He was previously the Group CEO of Barclays plc for three years until July 2015.

Jenkins holds an MA from the University of Oxford and an MBA from Cranfield School of Management.
The Fintech Action Plan was announced in March 2018 by the European Commission (EC) to support innovation in European fintech, while managing the risk that disruption can create. As a supporting initiative to the Capital Markets Union, it is intended to help harmonise the approach that national competent authorities take towards a range of fintech services and technologies. Laurence Caron-Habib, Head of Strategy, Public Affairs and CSR, and Philippe Ruault, Head of Digital Transformation, both at BNP Paribas Securities Services, discuss their views on the Fintech Action Plan, challenges to the plan and what’s next.

**A GOOD AND COMPREHENSIVE APPROACH TO SUPPORTING FINTECH**

**Q:** What are your views on the approach the European Union (EU) has taken with the Action Plan?

**Laurence Caron-Habib:** At this stage, the EC has decided not to regulate fintech. We consider this approach to be positive as regulation at this stage would impede innovation and both industry and public authorities still need to mature. At the same time, the EC has clearly prioritised areas where progress can be made, without disrupting innovation, which we support.

The EC has addressed most of the topics we need to look at in fintech. There are recommendations and initiatives in particular around distributed ledger technology (DLT), crypto assets and also on cloud technology, which is a significant issue for many players and one of the trickiest today. It also has an approach on the issue of cybersecurity, so we can say it is a comprehensive action plan.

**Philippe Ruault:** I think the approach is good, especially the observatory on blockchain. The sandbox is interesting and mirrors what the Financial Conduct Authority has done in the UK. It allows fintechs to start operating in a supervised but free environment. This is a good model.

**“The European Commission has addressed most of the topics we need to look at in fintech. It also has an approach on the issue of cybersecurity, so we can say it is a comprehensive action plan”**

**LAURENCE CARON-HABIB**
Q: Is having such a broad approach too much for a single framework?
PR: It sits in parallel to what we are doing, and what is top of the agenda for us and other banks. There is no way that we can look at transformation of the industry without tackling these subjects, even if they are many.
LCH: Many of these topics are interconnected. If you look at DLT and crypto assets, you need to have a global view. At this stage, I think it is relevant to have a single action plan. In the future, as we adopt new measures, it will be necessary to take a different approach.

Q: Are the measures appropriate to the different maturity levels of these technologies and services? They are much more detailed about crowdfunding than DLT.
PR: Crowdfunding is very mature. It has two to three years of economic activity and so there is a high priority to set a framework as there is a market in crowdfunding that needs to be addressed.
LCH: The crowdfunding use case is clearly defined, which is not the same for DLT, robotics or artificial intelligence (AI), for which we are still in the experimentation phase, at best. For crowdfunding, we have sufficient maturity to look at the best approaches to business and the right business cases.

Q: What is the most impactful improvement?
PR: The sandbox will have the most impactful improvement. A successful fintech sector needs to be able to develop at a small scale, but reach a much bigger market quickly. A European sandbox will help to facilitate that growth.

Q: Are there gaps?
PR: Around AI, yes
LCH: I think regulators globally – but also the industry – need more time to have a clear understanding of the risks associated with these technologies. Today, we mainly focus on their potential to add value, how they can be included in existing processes or can change the customer journey and experience. The risk and the governance requirements associated with the use of these new technologies need to be understood as well. For example, should there be exams or certifications for some AI tools? How can we stress test them and what audit trail is needed? These are questions that should be asked.
PR: You need to have some supervision of AI and some skills at the local regulator level to audit use. Something not yet addressed is the extreme risk that might stem from dependency on technology. For example, if there is an increased dependency on AI technology, what might...
that mean in the event of a cyberattack or a power cut? We are working on this at a company level, but some governance and direction from authorities for the wider industry would be welcome.

**Q:** What would the European market for fintechs look like without this EC initiative?

**LCH:** We already see there are a lot of local initiatives. For example, in France the authorities have been very progressive on several issues. We have seen the launch of mini bonds that can be issued on blockchain. There are many discussions regarding initial coin offerings. In Denmark and the Netherlands, they have launched sandbox schemes to enable fintech businesses to test new technologies and business models on customers in a safe environment.

If the EU authorities bring in measures too late, this could disrupt the steady growth of the sector.

**PR:** By their nature, fintechs are global, so their business model relies on reaching out to the wider world. Having different regulations in every country, followed by an attempt at harmonisation, might prove fatal to those initiatives aimed at building out a global business.

**LCH:** A positive point is that European supervisory authorities are associated with the various recommendations issued by the EC. That means that, from the start, they are aware of the developments and have a key role to play in terms of convergence. This is true of regulatory aspects, but it will be the case even more in the future for supervisory aspects as well.

**Q:** What are the existing obstacles to the adoption of fintech?

**PR:** The first obstacle is that there are many fintechs. Even when we select a specific topic, such as machine learning for email processing, there are many fintechs in scope and their emergence is very complex to manage.

We also have issues in terms of scale. For a group such as BNP Paribas, working with a fintech business of two to three people is difficult. It can create an economic dependency which has legal consequences. That is not easy to resolve.

Sharing data with fintechs can also be problematic. When working on cloud technology, for example, we need a high level of protection from cyberattacks. We are sometimes unable to work with fintechs whose security level is not the same as a G-Sifi organisation [global systemically important financial institution] such as BNP Paribas.

**Q:** Guidance on cybersecurity can be disproportionately harsh on major institutions. Has the EC approach struck the right tone?

**LCH:** Cybersecurity is not an easy topic. It is more about sharing best practices today, which is positive. Everybody is aware that sharing of information is needed because this is the best way to protect ourselves from these attacks. At the same time, there is the confidentiality dimension. Today we have rules at a local level around cybersecurity. The next phase is to combine the best aspects of these local rules into a regional or global framework.

Certainly, setting out a framework for reporting incidents and the timing of reporting to authorities are not punitive kinds of measures. A repository in which all potential attacks are recorded is the best way to alert potential victims to the dangers, and deter attackers from future attempts.

**Q:** What areas should be focused on next?

**PR:** The next areas will be compliance and regtech. Know your client, Markets in Financial Instruments Directive II reporting and fraud detection are among the next generation of fintech initiatives. The European cloud will also need to be part of the European discussion. Europe is looking to fund any initiatives that support cloud technology at a European level. An Amazon-like model is being considered.

**LCH:** There are currently local barriers in cloud use across jurisdictions, particularly on the regulatory side. The main request from the industry is to have a common European framework. There is a big demand from the industry and the EC is aware of that. We will see what recommendations it makes.
ChanginG ATtiTUDES to Risk

Global

The well-telegraphed changes in monetary policy. As the Federal Reserve (Fed) continues its tightening policy, 2019 will present opportunities to monetise market inefficiencies. The steepening interest rate curve offers clients engaged in cash collateral an opportunity to benefit from the carry between the cost of funds and yield received from the cash collateral investment. Clients may consider adopting a cash collateral programme to take advantage of this interest rate mismatch opportunity.

The steepening LIBOR curve also provides an opportunity for beneficial owners to capture higher yields on their reinvestment portfolios. The ability to lend general collateral and reinvest the cash collateral into a pool of diversified money market instruments enables clients to derive additional return.

This strategy is highlighted by the continued inflows of securities lending cash collateral into prime money market funds. Since the implementation of the Securities and Exchange Commission’s (SEC) 2a-7 money market reform, beneficial owners continue to allocate a portion of their cash collateral to higher yielding investments to capture this market inefficiency.

While cash collateral represents a significant portion of our client strategies, non-cash collateral lending continues to dominate the collateral universe. The industry has been lobbying the US regulatory authorities to expand the permissible collateral a counterparty can pledge in a non-cash collateral transaction to include equities.

What’s in Store for Securities Lending in 2019?

BNP Paribas Securities Services’ securities lending experts from across the globe reflect on key developments in the sector during the past 12 months and look ahead to what lenders can expect in 2019.

US

Securities financing markets in the Americas will face similar challenges throughout 2019 to those we experienced in 2018. We anticipate markets will continue to be impacted by volatility created through monetary policy and continued geopolitical tensions.

The primary driver of volatility in the US market will likely be the well-telegraphed changes in monetary policy. As the Federal Reserve (Fed) continues its tightening policy, 2019 will present opportunities to monetise market inefficiencies. The steepening interest rate curve offers clients engaged in cash collateral an opportunity to benefit from the carry between the cost of funds and yield received from the cash collateral investment.

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Market participants will greatly benefit from such changes to SEC Rule 15c3-3, resulting in higher volumes prompted by the efficient usage of counterparty balance sheets and capital. Regulation has prompted financial institutions (FIs) to more closely monitor their balance sheets and liquidity. The ability to pledge securities as collateral helps an FI preserve its liquidity position and put more assets to use. The focus on balance sheet allocation shifts the demand to borrowing non-cash assets, which offers broker dealers an opportunity to net and move transactions off balance sheet. Non-cash collateral-based transactions are less balance sheet-intensive than cash collateral-based transactions, hence the growth in non-cash collateral. We anticipate these changes will happen in 2019.

Lending general collateral securities and high quality liquid assets (HQLA) will remain popular. The market continues to have an insatiable appetite to borrow HQLA and clients willing to examine the tenor and permitted collateral received in these collateral transformation transactions will be compensated appropriately.

Despite the lack of ‘specials’ in the US Treasury market, lending opportunities still exist. Throughout 2018, several benchmark issues were highly sought after, often receiving hefty premiums to lend. We anticipate these will increase in 2019 as the Fed’s Federal Open Market Committee continues its tighter monetary policy.

The 2019 securities lending equity markets will be much the same as in 2018. The impact of Amazon on the retail space, along with borrowing securities linked to the biotechnology sector, will remain factors in demand. Further, the demand for exchange traded funds (ETFs) will likely continue. ETFs linked to politically sensitive regions or sectors are showing signs of continued demand as geopolitical impacts across the globe unfold. Finally, the healthy status of corporate balance sheets will most likely continue to drive significant merger and acquisition activity.

Implementing a combination of the above strategies, along with opening new markets and examining new trade structures, will assist clients in generating enhanced programme revenues.

Securities lending revenue from European markets in 2018 saw a healthy increase in both fixed income and equity markets. While we anticipate challenges in 2019, we remain optimistic that we will continue to bring incremental value to clients who participate in our agency lending programme.

Within European fixed income, lending HQLA will remain a strong driver as borrowers impacted by regulation continue to create demand. The regulation driving change in borrower behaviour and collateral includes the Supplemental Leverage Ratio (SLR), the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). These requirements are natural drivers for HQLA demand, so the ability to lend these assets on a term structure instead of overnight will be highly sought after.

EUROPE ● Securities lending revenue from European markets in 2018 saw a healthy increase in both fixed income and equity markets. While we anticipate challenges in 2019, we remain optimistic that we will continue to bring incremental value to clients who participate in our agency lending programme.

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We anticipate a trend for borrowers to look to place more varied types of non-cash collateral. Therefore, agents will need to assist lenders to understand the inherent risks, as
BNP PARIBAS SECURITIES SERVICES AGENCY-LENDING GLOBAL PROGRAMME UPDATE

2018 was a transformational year for our agency-lending programme. A combination of organisational changes and enhancements to our platform's operating model has enabled us to better service our existing clients while preparing the business to grow substantially.

BETTER EXECUTION

Our global lending platform now enables assets in any market across the globe to be placed on loan 24 hours a day, five days a week. This model results in better execution for client assets due to the local expertise of lending desks around the world to distribute assets in their local markets.

A single lending platform also permits a full suite of lending transactions, including cash and non-cash collateral. These provide clients with a range of options when lending across the globe in accordance with their risk profiles.

The adoption of this proprietary platform technology will make our business more efficient while strengthening counterparty relationships. We expect to expand our trading counterparties to approximately 90 different borrowers in early 2019. This will benefit clients directly as the distribution network of programme participants expands.

MANAGEMENT STRUCTURE

We have implemented changes in our management structure to realise the major developments we’ve made in our Agency Lending Global Programme.

BNP Paribas Securities Services often provides multiple services to our clients and our management changes are also designed to holistically meet the overall needs of our clients.

In summary, we are committed to providing clients with an industry-leading securities lending platform and optimistic for securities finance for the year ahead.

ASIA-PACIFIC

Consistent with other regions, due to the regulatory capital requirements we have seen increased demand for global fixed income assets traded within the Asia-Pacific time zone. This demand is likely to continue in 2019, with a need for longer-term structures and flexible collateral schedules. Key revenue opportunities lie in the acceptance of Korean, Taiwanese and China A-shares and continued appetite to borrow HQLA such as Australian government bonds.

General collateral (GC) trades in equities are a core driver of revenue across liquid markets such as Hong Kong, Japan and Australia. Industry returns in Hong Kong and Japan were positive throughout 2018; however, proxy voting has had a negative impact on the Australian domestic securities financing market. There are no signs of this abating in 2019, due to the corporate governance requirements of beneficial owners.

We see significant opportunities for agency-lending in South Korea and Taiwan. GC levels have normalised in recent years for South Korea, as the onshore lending market has grown and liquidity of supply has increased. However, it is still a ‘specials’ driven market, generating high returns on lendable assets.

In summary, the outlook for agency-lending in Asia-Pacific for the year ahead is one of growth and opportunity.
ANJULI PANDIT’S ON A MISSION

It is the business of every individual, company and government to help meet the UN’s Sustainable Development Goals, says the Primary Sustainability Manager for Global Markets at BNP Paribas CIB.
Creating a socially responsible business was once a phrase trotted out for PR effect, a poor relation to the real goal of delivering shareholder value. Those days are gone. The United Nations (UN) Sustainable Development Goals (SDGs), set in 2015, have become an important catalyst in shifting attitudes. The 17 goals range from delivering affordable and clean energy through to gender equality, eliminating hunger and combating climate change.

Anjuli Pandit, Primary Sustainability Manager, Global Markets at BNP Paribas CIB, discusses progress in achieving the goals and the critical role of financial services companies.

How and why were the UN SDGs created? What does the UN hope to achieve and how has the business community become involved?

It was a phenomenal feat when 193 countries came together at the UN in 2015 and agreed on 17 global goals. The SDGs provide a definition of what sustainability means and what a prosperous planet would look like. It puts every major issue on the radar, and the UN wants the business community to take collective responsibility for achieving them.

**What has the financial services industry contributed towards meeting the goals? How and why is this project relevant to the industry?**

The industry has a central role to play. Its power to influence who gets the money is critical. For instance, if a sovereign wealth fund decides to invest heavily in energy transition, it will change the future of that industry or the country in which it is investing. We have to make sure we find the money to create solutions to these problems – and that we move money away from places that are causing them.

**Which of the 17 goals have seen most progress?**

In climate change there have been big steps forward with COP 21 [the 2015 Paris climate change agreement]. Every participating country must have a climate action plan and most large global firms are measuring and reporting on their carbon footprints.

Gender equality and women’s empowerment have taken centre stage in the last few years too, with the UK mandating pay gap reporting and the #MeToo movement questioning how safe women feel in the workplace.

**“The financial services industry has a central role to play. Its power to influence who gets the money is critical. We have to find the money to create solutions to these problems – and move money away from places that are causing them”**

ANJULI PANDIT

Many organisations are looking at gender bonds and gender funds, where a project might directly benefit and empower women in rural areas through economic opportunity and access to work.

Infrastructure, industrialisation and innovation are all moving at a rapid pace and have been for the last few decades. Digitisation is helping manage the enormous amount of data that we need to solve different sustainability issues. It facilitates a lot of auditing and reporting to understand whether a proposal is a genuinely green or social project. And it has practical uses, such as using digital satellite imagery to monitor the heat efficiency of a building.

**Which goals have received less attention?**

Oceans, where acidification and coral reef degradation are big issues, have a long way to go. The plastic in oceans is something that everyone has plugged into. People are looking at their own plastic use, even things like deciding not to use a straw next time they have a drink. That is the way we want to approach these SDGs, with a sense that every little bit counts.

In biodiversity, life on land has a long way to go as global population growth competes with the preservation of flora and fauna.

For food security, there are parts of the Middle East and Africa that are becoming uninhabitable and non-arable because of desertification. The poorest are suffering the most.

Water is an issue that has been overshadowed in comparison to the climate debate. We forget how vulnerable our water resource is.

**What part has BNP Paribas played in meeting the goals?**

We have mapped our entire business to the UN’s SDGs. →
For climate action, for example, we have set science-based targets for ourselves to reduce our carbon footprint towards the 1.5C scenario – the globally agreed level at which to limit temperature rise to curb global warming. And we have made decisions on our loan book to support the energy transition. We have divested from areas we don’t believe will be productive in the future – such as new coal-fired power plants – and we have an active target of GBP 15 billion investment in renewable energy.

We are leaders in green bonds and are developing other products like positive incentive loans, which give corporates reduced rates if they exceed their sustainability targets, or charge more if they fall short. We are moving into social impact bonds. In Connecticut, we are working with the state government to fund local charities that support troubled families to keep children out of the care system. We get paid based on success – if a parent passes a drug test, for instance. The state saves money on its care bill but, more importantly, children from troubled families go on to lead better lives.

We are going out to our clients across the spectrum, trying to figure out finance solutions to their sustainability challenges. We want to make it financially viable for them to switch to sustainable practices and incentivise them for doing so. It makes us partners with clients on those projects and highlights the values we share in common.

What are the risks to the sector, and the world, if we fail to achieve the goals?
Even if you don’t care about social and environmental issues, the financial cost of failing to tackle these issues is enormous. In a world where billions of people became impoverished because we failed to protect our planet’s resources, it would be impossible to do good business.

Which areas of the world are leading in adopting sustainability? How is the private sector reacting?
Europe has been a leader in areas like energy transition and sustainable transport. In India and China, there is a massive leapfrogging in how they look at sustainable energy – making alternative energies a core part of their mix and adapting them rapidly. In the US, individual states and cities are still leading the way, despite a lack of clarity on how the central government stands on issues like gender equality and the environment.

When it comes to companies, investors are more bullish than corporates in asking for and demanding improvements in sustainability. But there are corporates that are excelling too, such as Unilever and Danone.

What would you encourage others to do to help achieve these goals?
It is important that every organisation undertakes the exercise of mapping their business to the SDGs. Dialogue is really important – that is why we organise our Sustainable Future Forums in Singapore, New York and Paris every year to bring corporates and investors together to talk about issues like water management, gender and new energies. Being an active participant in those conversations is how we will find solutions.

Sometimes there is pushback saying ‘this isn’t our business – our fiduciary duty is to shareholders’. I would challenge that in today’s world. For the first time, people at board level are starting to believe and act on the fact that safeguarding our people and planet is their business too. I think it is the business of every individual, company and government.
TAKING THE TEMPERATURE ON ESG INVESTING

It’s been almost two years since we published our first examination of how organisations approach environmental, social and governance (ESG) investing. The results took us all by surprise, not least the intention of institutional investors to double their ESG investing over two years.

Fast forward two years and we wanted to conduct the research again to see what has changed, and whether ESG intentions are here to stay in a bumpier market. Research is just back from field and we have the interim results based on the views of 340-plus asset managers and asset owners around the world. The final survey will be published in Spring of 2019.
On 1 January 1999, thousands of people surrounded a large euro sign in front of the European Central Bank headquarters in Frankfurt, Germany to mark the launch of the new currency. As the euro reaches its 20th anniversary, the Eurogroup – an informal body of eurozone country finance ministers – has described the currency as “one of the greatest achievements of European integration”, adding that “the euro has become a tangible part of the European identity”. Today, it is used by 340 million people in 19 countries, making it the world’s second most used currency.
China is becoming an increasingly important market for international investors, not only because of its size, rapid growth and economic potential, but because its capital markets are becoming easier to access.

### WHAT IS IT?

- **RQFII** (Renminbi Qualified Foreign Institutional Investor) - Launched 2011
  - One-way, direct-into-China trading mechanism for foreign institutional investors with offshore RMB accounts

- **STOCK CONNECT** (Mutual Recognition of Funds) - Launched 2014
  - Two-way, cross-border equities trading mechanism: Shanghai - HK; Shenzhen - HK; institutions and individuals outside China can buy Chinese A-shares, Chinese investors can buy HK equities

- **MRF** (Mutual Recognition of Funds) - Launched 2015
  - Two-way, cross-border fund recognition scheme for HK- and Chinese-domiciled funds - approved funds can be distributed in other market

- **CIBM** (China Interbank Bond Market) - Launched 2016
  - One-way, direct-into-China trading mechanism for foreign institutional investors

- **BOND CONNECT** - Launched 2017
  - Inward-only trading mechanism for foreign institutional investors

### WHAT CAN BE TRADED?

- **RQFII**
  - Stocks, bonds, funds, warrants, IPOs, futures, FX derivatives

- **STOCK CONNECT**
  - >1,600 Chinese A-shares via HK; 318 HK equities via Shanghai; 442 via Shenzhen

- **MRF**
  - 50 Chinese funds from HK; 10 HK funds from China

- **CIBM**
  - Chinese government and corporate bonds

- **BOND CONNECT**
  - Chinese government and corporate bonds

### HOW MUCH IS TRADED?

- **RQFII**
  - Quota per investor and in the aggregate: ~200 institutions registered, average quota RMB 3bn (USD 470m); aggregate quota RMB 191bn (USD 285bn)

- **STOCK CONNECT**
  - Daily volume limit, not in aggregate - USD 125bn trading volume per month in 2018

- **MRF**
  - N/A

- **CIBM**
  - ~400 institutions registered, including 70 central banks, international finance institutions and sovereign wealth funds

- **BOND CONNECT**
  - 425 investors registered, USD 12bn trading volume per month in 2018
China is the second largest economy in the world. It is also home to the second largest equity market. According to figures from BNP Paribas, it is valued at USD 14tn (about 45% of the size of the US market), and is the second largest domestic bond market, valued at USD 12tn (about 33% of the size of the US market). But foreign investors have only scratched the surface. Bloomberg data reveals that they only own around 2% of the bond market, and closer to 1% of the equity market according to a white paper published by EFG Asset Management.

This is set to change. Both active and passive fund managers are likely to increase their Chinese holdings as Chinese equities and bonds are added to global indices. Chinese equities are now being added – albeit gradually – to the MSCI Emerging Markets Index, and local bonds are to be included in the Bloomberg Barclays Global Aggregate Index and the FTSE Russell Index from 2019. It’s also becoming easier for investors to access Chinese markets. New routes-to-market with far fewer regulatory barriers have been added over the past few years and older investment schemes are becoming more investor friendly.

Here, we show how Chinese capital markets are now more accessible, with a summary of the different routes-to-market available to international investors.

**KEY:**
- **HK** = Hong Kong
- **RMB** = Renminbi
- **FX** = foreign exchange
- **HKE** = Hang Sang Index
- **CSRC** = China Securities Regulatory Commission
- **A-shares** = Stocks of Chinese corporations, RMB denominated, traded on Shanghai and Shenzhen exchanges

1. **WHAT ABOUT REGULATION?**
   - Lighter regulatory requirements than QFII, but still significant, including need for:
     - licence from CSRC
     - approved investment plan
   - Offshore investors protected by HK laws (Hong Kong Securities and Futures Ordinance) when investing in Chinese stocks through HKEX
   - Lighter regulatory requirements than QFII and RQFII:
     - no quota
     - no investment plan
     - no Chinese regulation for offshore investors, HK regulated
     - no need to move funds under FX control

2. **WHAT ARE THE MECHANICS?**
   - Need to establish local custodian relationship with offshore RMB settlement account
   - Trade, clear and settle with offshore infrastructure
   - Real delivery vs payment (DVP) in place – cash and stock ownership transfer at the same time

3. **WHAT IS THE FUTURE SCHEMES?**
   - Trading via e-platform provides electronic access to Chinese market makers, no routing through onshore bond settlement agent
   - Trading must be via appropriately licenced banks, relationship with onshore settlement agent required
   - Trading via e-platform provides electronic access to Chinese market makers, no routing through onshore bond settlement agent
   - Trading via e-platform provides electronic access to Chinese market makers, no routing through onshore bond settlement agent

4. **OTHER SCHEMES**
   - QFII (Qualified Foreign Institutional Investor) – launched 2002
     - One-way, direct-into-China trading mechanism for foreign institutional investors
   - Shanghai–London Stock Connect (scheduled to open early 2019)
   - IPO Connect
   - ETF Connect

5. **KEY:**
- **HK** = Hong Kong
- **RMB** = Renminbi
- **FX** = foreign exchange
India’s foreign portfolio investor regime has been received positively by global investors, who are now keener than ever to invest their money in what was once perceived as a highly bureaucratic market.
India’s foreign portfolio investor (FPI) regime has been welcomed by the investors who have a strong investment appetite for India, with the biggest grouse among them being that India was perceived as a highly bureaucratic market. The changes driven by the government under the guidance of the regulators has been received very positively by global investors, who have multiplied their investments in the country.

Think of it as India’s before-and-after shot. Since 1995, when the foreign institutional investor (FII) regulations were first announced by the Government of India under the guidance of the capital markets regulator, the Securities and Exchange Board of India (SEBI), FIIs had to go through multiple bureaucratic procedures and timelines before the investors were able to procure the FII licence to invest in Indian capital and debt markets. This continued up until 2014 and in itself had put off several large institutional investors from looking at India as an investment destination.

“Just a few years ago, it used to take a long time for a foreign investor to get a trading licence,” says Sanjay Singh, Head of Global Markets at BNP Paribas India. “The paperwork involved in getting a licence and being able to serve, say, 20 accounts, was so voluminous that documentation could be a full-time job. On-boarding was a time-consuming and complicated process. It often took several months to complete the process,” adds Christophe Beelaerts, Chief Executive of BNP Paribas Securities Services India.

SEBI’s sweeping changes

In June 2014, SEBI revamped the FII regime and brought in the FPI regulations, thereby merging foreign institutional investors, sub-accounts and qualified foreign investors to create a single investor class.

The new regime was well received by investors, with over 1,000 new FPIs registered in the subsequent 14 months. Investors were relieved by the smoother entry process and the on-boarding experience, which, according to Beelaerts, was “reduced to just around four to six weeks – quite an achievement”.

The key change rung in by the regulator was that the task of registering the new FPI accounts was delegated to designated depository participants (DDPs), which were local custodians that needed to register themselves with the regulator as DDPs.

“We have had a lot of discussions with the Securities and Exchange Board of India, looking for ways to continue to ease the process, and bring more foreign institutional investment into the country”

CHRISTOPHE BEELAERTS, CEO, BNP PARIBAS SECURITIES SERVICES INDIA
With account registrations now managed by DDPs under the guidance of the regulator, timelines automatically reduced. The new rules were also more streamlined and inclusive, and naturally adaptive to further modification and alteration. BNP Paribas is registered with the regulator as a DDP.

FPIs were sub-divided into three categories, depending on their risk profile and know-your-customer (KYC) requirements. Category I housed low-risk entities such as foreign governments and state-run investors, including sovereign wealth funds. Category II comprised the largest pool of FPIs, including most broad-based funds, investment managers, etc., while the rest filtered into Category III.

The KYC documentation required varied depending upon the categorisation of the client. An FPI could go ahead and invest after the issue of the FPI licence.

**Relaxing the norms**

“We have had a lot of discussions with SEBI, looking for ways to continue to ease the process, and bring more foreign institutional investment into the country,” explains Beelaerts.

SEBI continues the process of evaluating and easing the regulations. In December 2017, SEBI relaxed entry norms by allowing funds located in countries with diplomatic ties to India to apply for FPI licences – boosting the inflow of capital from emerging and frontier markets. Two months later, the regulator further eased the process of migration by relaxing the norms to apply for an approval to the regulator for a change of the local custodian. The revised process now gives the powers to the incumbent and new custodian to approve the migrations without needing the intervention of SEBI.

“Any client – an asset manager, say, or a global hedge fund – no longer needs to apply to the regulator to get an FPI licence or to change their custodian. Now you can apply for an FPI licence easily with a SEBI authorised DDP like BNP Paribas Securities Services,” says Singh. “They can approach DDPs directly and apply for FPI registration and within four weeks, post-documentation, the FPI can go live for trading. In many cases, the approval process has gone from several months to just a few weeks.”

**What’s next?**

The regulator is looking at best practices to make it easier for foreign investors to put money to work. In his 2017–2018 budget speech, Finance Minister Arun Jaitley flagged up the need for a simple common application form for all new FPIs. Foreign investors currently have to open a bank account and apply for a demat account and a permanent account number, as well as filing a separate form to register themselves with the DDPs.

A common application form would eliminate a lot of paperwork, reduce duplication and ease further the process of FPI access to India’s capital markets. The new rules are expected to be introduced in the first half of 2019.

So, is the new-broom regime working? Well, yes and there is scope for further increase. Foreign investors remain as enamoured of India’s growth story as ever: institutional capital...
continues to flow into underpriced securities and the property sector is enjoying a timely return to form. That said, it has been a mixed year for many Indian stocks, weighed down by rising oil prices and fears of a global trade war. The BSE Sensex was up just 3.9% on the year-to-date at the end of trading on 10 December 2018.

Despite these uncertainties, there’s no doubt these new regulations make life much easier for investors. “Everything is so much more streamlined,” says Beelaerts. “The custodian, rather than the regulator, is in charge of compliance and KYC. The real, tangible benefits have been felt by the client and the foreign investor is keener than ever to put their money in India.”

**Market-friendly framework**

SEBI has undertaken a lot of road shows across several countries to showcase the market-friendly framework to the world. “Both SEBI and the two big domestic stock exchanges [the National Stock Exchange of India and the Bombay Stock Exchange] have done a lot of work around the globe to promote the FPI regime,” adds Beelaerts.

The major thrust to unify all foreign investors under a single regulatory umbrella predates current Prime Minister of India Narendra Modi’s administration by a few months. India ranked 132nd in the World Bank’s 2013 Doing Business report. In its 2019 report, India ranked 77th, up 23 places over previous year.

“Now you can apply for an FPI licence easily with a SEBI authorised DDP like BNP Paribas Securities Services. In many cases, the approval process has gone from several months to just a few weeks”

SANJAY SINGH, HEAD OF GLOBAL MARKETS, BNP PARIBAS INDIA

Several changes to the economy have been driven by the prime minister. Ever since the National Democratic Alliance government came to power, Modi has promoted manufacturing, boosted spending on infrastructure and encouraged securities regulator to be more investor friendly.

“Many of the reforms we’ve seen in tax, financial services, regulations and foreign investment have only been possible because you now have a majority government in charge,” concludes Singh.
In a dynamic, fast-changing region, third-party clearing helps banks and brokers adapt to new technologies, regulations and settlement standards, says Julien Kasparian, CEO, BNP Paribas Securities Services Hong Kong.

In June 2018, China set itself up on the global stage, giving foreign investors access to a large slice of its USD 11 trillion bond and USD 7 trillion equities markets. After MSCI’s decision last year to add 222 China A Large Cap stocks to its Emerging Markets Index, global investors suddenly awoke to a new reality.

- Chinese A-shares would need to be part of their portfolios. This followed on from Hong Kong’s stock exchange announcing major changes to its listing rules and procedures, in a bid to gain a bigger share of the global IPO market in late December 2017. And as momentum continued to swell, Bloomberg announced that it would study the inclusion of Chinese bonds into its global indices by April 2019.

Opportunities abound for investors looking to diversify their portfolios in Asia-Pacific. Yet, with these changes come complexities given the unique characteristics of each Asia-Pacific market by way of regulations, trading infrastructure and risks.

While investors are seeing a growth in opportunities, there are wider implications for financial intermediaries in the region. Coupled with regulatory changes, new products and technologies, Asia-Pacific markets are looking to transform their clearing and settlement practices. Following Australia’s
lead in using distributed ledger technology, exchanges in Hong Kong, Singapore and Japan are each considering their own approach to blockchain. Markets such as India and Malaysia are considering adopting SWIFT’s ISO 20022 messaging format, which could replace legacy systems connecting to central counterparty clearing houses (CCPs) and central securities depositories (CSDs). And at a time when local regulators are reassessing capital requirements, risk reduction is driving markets towards shorter settlement periods, which can prove challenging for European and US investors trading in the region unless they have a regional presence.

In a dynamic, fast-changing region, comprehensive custodial, clearing and settlement services are crucial. Unlike self-clearing, third-party clearing (TPC) provides the most benefits and flexibility, while offering significant cost savings.

**Flexibility and efficiency**

Asia poses a number of key differences compared with Europe and the US, with liquidity constrained given the number of different currencies used across Asia’s diverse markets. This means investors in Asia-Pacific are more exposed to FX transactions, sometimes leading to delays and impacting intraday trades.

“Now this is the right time for banks and brokers to review their current operating model based on the changing regulatory and infrastructure landscape combined with mounting cost pressures and a squeeze on margins”

JULIEN KASPARIAN,
CEO, BNP PARIBAS SECURITIES SERVICES HONG KONG*
liquidity requirements. Similarly, brokers that operate regional hubs in Asia-Pacific may need to move funds from market to market to effect the timely settlement of transactions with their clients.

One solution is for brokers to seek intraday liquidity solutions from their banking partners. These solutions need to be flexible enough to cover any peak activity that comes from rebalancing periods from their clients, while not creating significant fixed costs that can hit profitability. The banking partner may request collateral or some other form of assurance from the broker to provide the necessary credit line and this can impact on the brokers’ overall asset structure.

Brokers that operate regional hubs in Asia-Pacific can work with their banking partners to settle transactions with clients in a timely manner across markets. TPC provides an alternative solution: the clearing party could, for instance, provide intraday liquidity solutions to the broker on an uncommitted, undisclosed basis to assist in the coverage of their daily activity. Another option to add more certainty and flexibility would be to do so on a committed or overnight basis. These solutions allow brokers to feel more comfortable meeting the needs of new clients with cross-border liquidity requirements and the clearing agent can use the assurance gained from their operation of the clearing and settlement flow to reduce the additional collateral requirement.

Staying ahead of regulation
Another advantage of TPC is that securities services providers make it their business to anticipate how regulatory changes will impact their clients. They can be relied on to reduce the cost of compliance and help brokers quickly digest and navigate an ever-changing landscape across Asia. A TPC model also helps streamline the clearing and settlement process, taking care of ongoing project expenditure on operations and IT, freeing up the broker to focus on its core business, winning new clients or on expanding into new markets and asset classes.

Capital requirements,
payments of margin calls and contributions to the default fund are all passed to a third-party outsourcing provider, which also assumes responsibility of preparing for future changes to market infrastructure. TPC does away with the need to maintain a separate relationship with a local bank for cash settlements and liquidity requirements. Even large international brokers, who might typically opt for self-clearing to handle high trading volumes, would be best served by a TPC partner, which can lead to lower and more manageable variable costs and avoids the international broker needing to keep a very close eye on each local market.

A TPC operator can also provide clients access to its technological expertise, which can be especially useful in managing changes to market infrastructure. As the implementation of new technology and the introduction of new messaging standards hastens across markets, adapting to the digitisation of post-trade systems can pose a challenge for smaller brokers, bringing higher costs and the need to re-evaluate current operating models.

BNP Paribas Securities Services owns a stake in US-based fintech company Digital Asset, which is developing a clearing and settlement system, potentially the first industrial-scale platform using distributed ledger technology, to replace the Australian Securities Exchange’s Clearing House Electronic Sub-register System, or CHESS.

**Global and local expertise**
A TPC partner combines the services of custodian, settlement agent, netting provider, liquidity provider, and settlement and cash bank, as well as a technology provider with guaranteed operational support. They also bring a consultative approach and dedicated teams of local experts to help manage new regulation and minimise its impact.

As the region implements wide-ranging changes to its market infrastructure, investors should seek a TPC partner well positioned to assist them in making the most of the immense opportunities offered by the Asia-Pacific markets.

“The pricing between custody and clearing providers continues to tighten. With less price differentiation, brokers are putting more consideration into booking models, overall returns and technology”
ANTHONY FORD, HEAD OF TREASURY, CLSA*

“Third-party clearing can offer market participants in Hong Kong significant benefits given that trading volumes are a key driver of the regulatory capital requirements for broker-dealers and significant changes are expected to market infrastructure in the coming years”
TOM JENKINS, PARTNER, HEAD OF FINANCIAL RISK MANAGEMENT, RISK CONSULTING, KPMG CHINA*

*Source: ‘Third party clearing: have brokers in APAC reached the tipping point?’, GlobalTrading round table discussion sponsored by BNP Paribas Securities Services, 9 May 2018
Having successfully weathered the recent economic turbulence affecting Latin America (LatAm), today Colombia remains in good financial standing and is increasingly viewed as a stable environment by global investors. Among those benefiting locally have been the country’s top insurance providers, which have continued to thrive as economic conditions have improved.

CUSTODY FOR COLOMBIA: A ‘GOLD STANDARD’ FOR INSURERS

Francesco Rossini, Head of Client Development, Hispanic LatAm for BNP Paribas Securities Services, discusses the merits of having a globally recognised custodian providing localised custody for Latin American insurance firms.
COLOMBIAN INSURERS EMBRACE BEST PRACTICE FOR ASSET SAFETY

BNP Paribas Securities Services is partnering with several leading Colombian insurance firms to implement best practices for asset safety.

Recently, Zurich-based Swiss Re Corporate Solutions enlisted us to implement best practices, already utilised in other markets, on behalf of its Colombian entity, Compañía Aseguradora de Fianzas S.A. Confianza (“Confianza”), which it acquired in 2014. Leveraging our global relationship with Swiss Re, we were able to implement a solution in an efficient manner that worked for the company.

Partnerships, like the one with Confianza, underscore our ability to help insurers automate risk management, reporting and other capabilities, allowing firms to reduce costs while prioritising core business activity. Having on-the-ground operational support was central to securing both arrangements, as it enabled us to demonstrate first-hand the benefits of having locally based managers who can respond to client needs in a timely manner.

Similar partnerships are likely to follow as other regional players move to adopt custody services as best practice in the region.

Despite recording double-digit gains of late, observers believe the industry’s relatively low penetration rates and growing consumerism can support additional growth. The government’s ambitious infrastructure plans under the fourth generation (4G) initiative are also likely to boost insurers’ fortunes. The 4G programme will see construction of 8,000km of roads and 3,500km of four-lane motorways.

Regulatory rule revisions have made it easier for foreign interests to get involved in Colombia’s insurance business through acquisitions of and partnerships with local firms. As the market becomes more crowded, insurers will find it necessary to sharpen their skill sets in order to remain competitive. A recent EY report says companies lacking system-wide integration due to outdated legacy systems face significant technology upgrades, required to improve distribution, analyse client data and handle other integral tasks.

Though not yet mandated by local regulators, partnering with a reputable custodian can help Colombia’s insurance firms achieve best practice in daily operations, risk management, reporting and other activities, allowing managers to fully focus on their key objectives.

The benefits of partnership

As the market in Colombia is not yet SWIFT-compliant, bolstering insurers’ communications competency remains key. This involves replacing outdated IT systems with an agile, state-of-the-art platform for generating reports and other critical information, while using automation to compile data...
across multiple sources, reducing the likelihood of siloed activity. A feature of our custody programme at BNP Paribas is Neolink, a web portal that streamlines the process of sending order instructions to the custodian, following strict standards for its execution.

Enlisting a third party to help monitor risk is also paramount, particularly given the increase in data demands within the insurance segment. At BNP Paribas, our data navigation analysis tools are capable of delivering highly granular risk and performance analysis, even when processing massive volumes of data. Over the near term, we believe this kind of benefit will become even more valuable to a wider range of regional insurers.

Despite the myriad of benefits available, a number of insurers have yet to take advantage of outsourced custody resources at their disposal. As key participants in a leading frontier market, these companies have much to gain by moving non-core activities to expert third parties.

**Added insurance**

Partnering with a custodian not only gives insurance firms access to an array of cutting-edge solutions and technologies, but also boosts investor confidence by adding a layer of operational independence. Rather than self-settling through a local Central Securities Depository, having an intermediary that uses automation to process daily tasks provides firms with a level of safety and assurance that is well worth the extra investment, particularly over the long haul.

**OUR PRESENCE IN COLOMBIA**

While rule changes have made it easier to access Colombia’s insurance market, we believe that having a local presence is the only real way to ensure consistency of client communications and service excellence.

Since entering Colombia in 2013, BNP Paribas Securities Services has offered foreign and domestic sell-side and buy-side clients a full slate of custody, clearing and settlement services.

From our operational support hub in Bogota, we offer account management not only to Colombian clients, but also to those throughout the Hispanic LatAm region. Offering this kind of centralised access ensures that clients have round-the-clock, real-time operational assistance in their own language, greatly improving transactional efficiency in the process.

Today, Colombia is one of 27 countries in BNP Paribas’ expanding global proprietary network, which includes access to over 90 markets worldwide. It is one of the most extensive networks of its kind within the industry, featuring local insights that allow clients to maximise their market and investment opportunities.

With over USD 11 trillion in assets under custody, BNP Paribas remains one of the globe’s fastest-growing custodians.
SRD II: DRAWING THE LINE FOR ISSUERS, INVESTORS AND INTERMEDIARIES

The revised Shareholder Rights Directive II (SRD II) is due to come into force in 2019. Developed in response to the financial crisis, and designed to increase transparency and enhance long-term shareholder engagement to combat previous market shortcomings, SRD II is widely recognised among industry participants as a move in the right direction.

Haroun Boucheta, Head of Public Affairs at BNP Paribas Securities Services, discusses the new directive’s impact on issuers and investors, and the intermediaries that service them.

What are the main goals of SRD II, and the expected benefits for issuers and investors?

The first Shareholder Rights Directive (SRD) came into force in 2007. It sought to foster shareholder engagement by implementing rules around transparency, proxy voting rights and the ability to vote in general meetings via electronic means.

However, the 2008 financial crisis exposed a number of shortcomings with the original directive. The European Commission highlighted the following in particular:

i) Shareholders often supported managers’ excessive short-term risk-taking, with too much focus on short-term returns

ii) Shareholders lacked the means to effectively monitor the companies in which they invested

iii) Deficiencies were apparent in the engagement and control by long-term shareholders, active managers and institutional investors

iv) Some directors’ remuneration was felt to be excessive and not justified by their company’s performance

v) Exercising shareholders’ rights was often complicated and costly, especially in cross-border situations where intermediaries could be located in different jurisdictions

SRD II – which was published on 17 May 2017 and is scheduled to take effect during Q2 2019 – aims to tackle these shortcomings. Its central focus is on encouraging more long-term shareholder engagement, enhancing transparency in the voting process and improving issuer-investor dialogue.

One new requirement for institutional issuers, such as asset managers, pension funds and insurance companies, is to develop and publicly disclose their engagement policy towards their shareholders. If these issuers choose not to do so, they must explain why.

SRD II also seeks to make it easier for shareholders to exercise their rights, and facilitate cross-border voting. To this end, intermediaries will have to ensure they pass relevant information from the issuer on to shareholders, and vice versa.

Another focus is on increasing transparency in the voting process, including where the services of a third party – such as proxy advisors or an investee company – are used. This implies new requirements on shareholder identification, so issuers can communicate directly with investors, and transparency of proxy advisor policies.

The other big change is a “say on pay”. This gives shareholders a right to vote during the general meeting on the directors’ remuneration policy, as well as on the remuneration report that details individual directors’ remuneration in the previous financial year.

BNP Paribas Securities Services supports these goals. Increased transparency could facilitate more dialogue between issuers and their shareholders. And when combined with other initiatives targeting long-term engagement and funding source diversification for issuers, SRD II could lead to longer-term engagement and investment in issuing companies.
What does SRD II mean for custodians and other intermediaries?

SRD II needs to be read in conjunction with the Commission Implementing Regulation 2018/1212, dated 3 September 2018. This contains a prescriptive list of obligations for both issuers and intermediaries, including custodians and other securities services providers.

The first new requirement is technological. Under SRD II and the Implementing Regulation, any transmission between intermediaries will need to be made in electronic and machine-readable ISO formats.

Other new requirements affecting intermediaries relate to the organisation of general meetings and corporate events, in an effort to enhance the efficiency of the chain of intermediaries and improve the transmission of information along it.

For instance, the last intermediary in the chain must confirm to the shareholder (or a third party nominated by the shareholder) their entitlement to exercise their shareholder rights in a general meeting. Intermediaries must also transmit to the issuer updated notices of shareholder participation in the general meeting, while the last intermediary must ensure the information regarding the number voted is consistent with the entitled position. The receipt, recording and counting of votes need to be confirmed as well.

The information to be provided on corporate events gives intermediaries strict deadlines regarding corporate actions and shareholder identification processes. Notably, the first intermediary, and any other intermediary that receives information regarding a corporate event, should transmit that information to the next intermediary in the chain without delay, and no later than the close of the same business day on which the request was received. Responses to such requests must then be provided and transmitted by each intermediary to the addressee defined in the request without delay, and no later than during the business day immediately after.

The Implementing Regulation driving these changes will be applicable from 3 September 2020.

Can technology – and distributed ledger technology (DLT) in particular – be a compliance enabler?

Where there is a chain of intermediaries, especially in cross-border situations, and the parties have to transmit specific information in ISO format and using electronic means along that chain without delay, then new technologies, especially DLT, could help firms meet the new requirements.

BNP Paribas Securities Services is currently involved in various discussions and market initiatives in this area. For example, we are collaborating with a number of large custodians and market infrastructures on the potential to create some independent utilities or market standards to function as a golden source that all intermediaries along the chain can use. BNP Paribas Securities Services strongly believes only a market-driven solution will have a chance of being successful.

DLT is one of the options the industry is investigating, as by its nature the technology would enable us to comply with the directive’s transparency requirements. In addition, the Implementing Regulation requires intermediaries to transmit the relevant information immediately, something for which DLT is well suited.

DLT use cases have been relatively limited to date, but there is a real trend emerging for market players and market infrastructures to leverage the technology. For example, the Australian Securities Exchange (ASX) plans to go live with a new DLT-based equity clearing, settlement and registry system by 2021, which it expects to result in better record keeping and data quality, streamlined reconciliations and more timely transactions.

Hong Kong Exchange and Clearing Limited (HKEX) is also working with Digital Asset on a post-trade allocation and settlement initiation platform to process China-listed A-shares under the Stock Connect programme. HKEX believes blockchain could help tackle the post-trade operational challenges that result from the tight settlement cycle for mainland China transactions.
Whether DLT can provide the solution to our SRD II obligations remains to be seen. But whatever solution, we are confident technology can help market participants provide the new services demanded by the directive.

**Given SRD II is a directive, will it be applied in a harmonised way across Europe?**

The fact that SRD II is a directive, rather than a regulation, means European Union (EU) Member States have some discretion in how they transpose the rules into their respective national laws. That creates the potential for different interpretations.

This potential for divergence is exacerbated by specific provisions within the directive itself, which allow Member States to deviate in key areas. In particular, Article 9.c.6 indicates that Member States may elect to exclude certain transactions from the scope of the directive, namely:
- Intragroup transactions
- Certain types of transaction for which national law requires approval by the general meetings
- Transactions regarding remuneration of directors
- Transactions entered into by credit institutions when financial stability is at stake

Another question mark is whether end investors will be able to choose not to receive general meeting information. Will such an “opt out” possibility be written into national laws when the directive is transposed? If so, intermediaries would need to filter information and customise reports based on what each investor wants to do, which would be an administrative headache.

Brexit poses a further complication, since the date for Member State transposition is after 29 March 2019, when the UK is due to leave the EU.

That said, SRD II has some extraterritorial scope. Its provisions apply to third-country intermediaries if they provide services for shares of companies whose registered office is in the EU, and the shares are admitted to trading on a regulated market in the Union. Third-country proxy advisors would also be subject to the directive as soon as they carry out their activities through an establishment in the Union, regardless of their form. Post-Brexit, UK-based institutions, as third-party providers, would therefore be captured by the directive’s provisions if they want to continue offering services within the EU.

Similarly, an industry-wide IT solution would need to cope with all Member States’ requirements. Harmonising the rules would help such a utility to generate the greatest possible efficiencies.

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**Haroun Boucheta is Head of Public Affairs at BNP Paribas Securities Services. Before joining the bank, he worked at Société Générale for 11 years. There, he served as Regulatory Lawyer before acting as Director with the Regulatory Strategy Team of Société Générale Global Banking & Investor Solutions, with responsibility for co-ordinating the business response to the evolving regulatory environment across the investment bank, in particular. Prior to that he was Legal Counsel at LCH for three years.

Boucheta holds a PhD in Financial Law and is also Associate Professor of Law (“Maître de Conférences Associé”) at the Université de Cergy-Pontoise, teaching banking and financial law.**
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