WE WOULD LIKE TO CONGRATULATE OUR COLLEAGUES...

Angelia Chin-Sharpe, for being named the 14th Most Influential Woman in Islamic Finance by WOMANi, organised by Cambridge International Financial Advisory

Carrie Cheung, for winning the “Trailblazer” category at the Women in Finance Asia Awards, organised by Global Trading Journal and Markets Media Group

Jane Ambachtsheer and Anne Marie Verstraeten, for being named in Financial News’ 120 Most Influential Women in European Finance 2019


* Bank of the West
** Claudine Gallagher is also the recipient of Markets Media’s 2019 Crystal Ladder Award and Crain’s Notable Women of Banking & Finance

Sustainability is part of our mandate, says AIIB CFO Thierry de Longuemar

LEAN, CLEAN AND GREEN

FIONA MULLIGAN: The evolution of the hedge fund investor

KARIN HALLIDAY: Constructive engagement and the G in ESG

SIMON OLENKA: The COO embarks on a new journey

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A new decade is an interesting and exciting time because it can start out one way and finish very differently. No matter what, it will have a sense of identity. What will the 2020s be known for? Gender equality? Combating climate change?

In this annual issue of Quintessence, we look at the things most on the minds of our clients as we enter the 2020s. Here are a few teasers to the magazine:

- The Asian Infrastructure Investment Bank (AIIB) has seen extraordinary growth in its first three years. We interview CFO Thierry de Longuemar to understand AIIB’s strategy in raising financing and in supporting the energy transition.

- If ever a role were the linchpin in a complex environment, but out of the spotlight, it is the financial services Chief Operating Officer (COO). So much so that we have conducted a global survey looking at how COOs spend their time, where they want to be more effective and how they see the role evolving.

- The three pillars of responsible corporate behaviour – the E, the S and the G – have historically been put under one catch-all umbrella, but they are very different lenses through which to view the impact and workings of an investee company. Three writers give a view of the evolution of each pillar.

- The low yield environment isn’t going away any time soon. As you know all too well, the side effects of unchartered territory are already being felt, not least increasing leverage and the shift of risk to so-called risk-free assets.

- On regulation, we look at two areas of investor protection soon to come into force – the fifth and sixth waves of initial margin for centrally cleared derivatives and securities financing transactions. How can firms best prepare for these next waves of regulation?

- In identifying investor trends, alternatives are in our spotlight, including ESG and private equity investing, and the impact of greater diversity on the hedge fund investor model.

- For technology, our theme is industry standardisation, whether it be the use of Application Programming Interfaces (APIs) by the securities services industry or providers supporting Asia Pacific stock exchanges as they innovate to use blockchain.

Finally, a big thank you to our external contributors – AIIB, KKR, Thales, AMP Capital, B3 Brasil Bolsa Balcão, Bolsa de Valores de Colombia, the Shanghai Stock Exchange and the London Stock Exchange.

We hope that Quintessence brings you valuable insights and will help inform your decisions in 2020. 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.

José Placido, Head of Client Development, Securities Services and Head of Financial Institutions Coverage, Corporate & Institutional Banking
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Asian Infrastructure Investment Bank (AIIB) CFO Thierry de Longuemar reflects on the Bank’s extraordinary first three years, its ESG-driven funding strategy and how the institution could make investments in infrastructure more mainstream.

In 2013, China embarked on an ambitious venture to bridge Asia’s infrastructure funding gap, which the Asian Development Bank (ADB) estimates to be USD 26 trillion through to 2030, as outlined in its 2017 report, Meeting Asia’s infrastructure needs. Keen to showcase its ability to create a new multilateral institution, China set out to invite other countries to join it in setting up the Asian Infrastructure Investment Bank (AIIB).

Operating on ‘lean, clean and green’ principles, AIIB would fund infrastructure projects in emerging markets – predominantly in Asia, but also in other regions, including Africa, Europe, the Middle East and Latin America – that had experienced highly challenging credit cycles in the past. As part of this strategy, it would develop infrastructure as an asset class aligned to Environmental, Social and corporate Governance (ESG) investing principles.

At AIIB’s official opening three years later, 57 countries had joined China. Today, it has 72 members and 28 prospective members.

In 2017, the Beijing-based bank awarded BNP Paribas Securities Services a global custodian mandate. Here, AIIB’s Chief Financial Officer Thierry de Longuemar discusses the Bank’s impressive progress, its focus on sustainable investing and its proposition to private investors.

Q: What have AIIB’s major achievements been so far? Setting up a new institution takes three to five years. We have almost completed this process now, which is a real achievement. The Bank approved its first loan six months after it had been established – that’s remarkably fast. We had been called upon by the World Bank, ADB, the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) to fill a USD 600 million financing gap for the Tanap [Trans Anatolian Natural Gas Pipeline] project. That pipeline connects a gas field in Azerbaijan with western Turkey, linking it to southern Europe. As a matter of comparison, the ADB financed its first project three years after having opened. We also received three AAA ratings from the world’s major credit rating agencies a year and a half after our establishment. That was a first in the history of multilateral financing institutions. The EBRD was granted three AAA ratings three years after starting its operations.

Q: In May 2019, the Bank debuted a global five-year bond on the capital markets, unlocking USD 2.5 billion of capital. Why do you think it attracted so much interest from investors? We started very early with a clear marketing strategy. We had met more than 200 investors from across the world during the two years leading up to the bond issue. This helped us achieve a successful transaction. Plus, it happens very rarely that a new AAA issuer enters the debt capital markets. The last major AAA issuer had been the EBRD in 1994. So, there was a lot of interest in our bond and we ended up not paying a ‘new issue’ premium. After announcing an indicative spread of eight basis points above swaps, we landed at six, which was exactly at par with an EIB five-year dollar bond launched a day earlier.

Q: Why did you choose that particular strategy? We will have received about USD 20 billion of paid-in capital by the end of 2019. That makes us the best capitalised multilateral financing institution in the world. As a matter of comparison, the International Bank for Reconstruction and Development’s paid-in capital –
“Private sector mobilisation is one of the three major priorities that the Bank is pursuing. In the past, multilateral institutions failed to attract ‘non-traditional’ lenders in infrastructure”

because it will enable households surrounding Beijing to funded other solar projects and wind farms in Asia. We have since also one gigawatt, which makes it one of the largest ever solar projects in terms of electricity capacity. The capacity of those 50 projects will be above a total 50 projects, which are all based in the same part of Egypt, not far from the famous Aswan Dam. This project is interesting because it’s a combination of 11 projects out of the desert. The value we bring to asset managers is that, through us, they find new ways to mitigate specific risks to infrastructure financing. Traditionally, there was a lack of interest in infrastructure, mainly because of financial risks – particularly for greenfield projects – during the building phase of infrastructure when no revenue is generated. There are also political risks. AIIB offers private sector lenders or investors the opportunity to get involved directly in the infrastructure asset class under a more attractive risk environment.

Q: Can you share some examples of the projects that you have been involved in? You talked about the Tanap project, but are you also funding renewable energy projects?

The first projects we funded were primarily in the traditional energy and transport sectors. As mentioned, Tanap was a traditional energy project. We also financed a highway in Pakistan and our first private sector project was a gas turbine power plant in Yangon, Myanmar, co-financed with the International Finance Corporation (IFC).

Q: What does the bank have in place to ensure that the projects it funds have a positive impact on local communities and the environment? All projects comply with the Bank’s environmental and social framework that was approved by its Board in February 2016. That policy is public. We have in-house environmental and social specialists who do their due diligence to check, before approval, if the project does indeed fit with the Bank’s standards for environmental and social principles.

Q: What role is the AIIB playing in the wider push for energy transition?

A great role, but with some challenges. For example, a low-income country that needs energy will generally opt for the cheapest source. If the cheapest source is coal, what is our response? Should we just tell them that we can’t fund their energy projects because they are not clean? If we do, others might say we are not supporting the development of low-income countries. It’s a serious dilemma.

If you look at the energy strategy of the Bank, we will finance investments that are compatible with a country’s trajectory towards a sustainable, low-carbon energy and internationally agreed targets. While fossil fuels will continue to play a significant role in the energy mix of most of our members, the Bank supports accelerating our members’ transition towards a low-carbon future, including lower-carbon emissions from fossil fuels. There are clean energy solutions but, in the context of a low-income country, they are sometimes not easy to implement.

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Less than half of S&P 500 and Fortune 500 financial services companies now have a Chief Operating Officer (COO). As the industry continues to move at pace, will the COO continue to be the linchpin of the financial services firm, or is the role in danger of buckling under the immense demands of complexity? Here, we speak to Simon Olenka, Head of Client Delivery UK at BNP Paribas Securities Services, about the results of a BNP Paribas global survey of financial services COOs, commissioned in autumn 2019.

THE FUTURE COO: TIME TO CHANGE?

What do you think is the biggest challenge for COOs today?

I think the challenge is finding the balance between all the different demands that we now face. We’re responsible for the traditional operational controls, managing the ‘production line’ and controlling budgets, as has been the case for decades. But now, the expectation is that the COO is an enabler of growth. She or he must generate change, and drive the organisation’s response to change, whether that’s arising from technology, competition or market dynamics. Of course, at the same time, the areas of regulatory compliance and governance also lie in our world – and those responsibilities are becoming more and more complex. So the job is demanding on about ten different axes – I am never bored!

Q: With so many responsibilities, do you think COOs suffer from an image problem? Is the title ‘Chief Operating Officer’ part of this problem?

There’s a famous Indian parable where a group of blind men hear that an elephant has been brought to town, but have no idea what an elephant is. Each one touches the elephant and each one comes away with a different idea. One →
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WHO IS THE FUTURE COO?

The focus of the Chief Operating Officer is changing, according to BNP Paribas’ global survey of COOs across the financial services sector, commissioned in autumn 2019.

Simon Olenka

Simon Olenka is Head of Client Delivery UK at BNP Paribas Securities Services, where he is responsible for Operations, IT and Change Management across a range of UK services. Olenka has worked in the investor services industry for nearly 30 years and, prior to joining BNP Paribas in June 2018, spent over 20 years at RBC in a variety of roles, including Head of UK and Ireland Operations, Global Head of Change Management and UK Country Managing Director.

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Environmental, Social and corporate Governance has become as familiar a trio as the Three Musketeers or Harry, Hermione and Ron. But each pillar has its own characteristics and importance for investors looking to better understand the risk embedded within their investments. Over the next three pages, we shine individual spotlights on E, S and G. BNP Paribas’ Trevor Allen highlights three environmental initiatives to watch in Europe, BNP Paribas Securities Services’ Florence Fontan explores the continuing challenges of assessing companies’ social performance, and guest contributor Karin Halliday, of AMP Capital, shares lessons on how her company is helping asset owners to measure governance performance across their equity portfolios.
1. A new taxonomy

The EU taxonomy is a systematic look at analysing and integrating environmental, social and governance factors into investments. With a new European Commission in place since 1 December 2019, all eyes are on Brussels to see where the environment will land in its order of priorities. The signs are good, suggests Trevor Allen, Sustainability Research Analyst at BNP Paribas Securities.

The EU taxonomy identifies specific sectors and the carbon limits that are permissible to qualify as an eligible green investment. For example, it identifies that investments in the energy sector should have emissions limits that are less than 100 CO2 g/km to qualify as a green eligible investment. For cars to qualify, emissions limits will need to be below 50 CO2 g/km.

2. Curbing pollution

The EU is cutting down on pollution from fossil fuel vehicles. The cities listed have all agreed to ban petrol and diesel vehicles in their city centres, while promoting electric buses to fully replace their fossil fuel counterparts ahead of the bans. This initiative will have obvious impacts on business – i.e. car manufacturing, mobility, local, small-scale shipping and courier services – but setting goals in advance allows business to assess the path forward and how they will scale up their fleets to comply with the bans.

In addition, the EU has a limit on emissions for car manufacturers. For example, the average emissions of all cars built by an individual EU car manufacturer must be less than 135 CO2 g/km. This number will be reduced to 95 CO2 g/km by 2021. This means that car manufacturers are currently re-investing, and will continue to re-invest, their profits to create lower-emission vehicles. Currently, the average passenger car manufactured in the EU produces 120.4 CO2 g/km, so manufacturers have significant work to do to reach this goal. This legislation will apply only to new vehicles and not vehicles sold prior to 2021.

The EU taxonomy is a systematic look at analysing and integrating environmental, social and governance factors into investments. It is early days and the EU taxonomy still needs to be passed by the European Parliament, but with the European Commission supporting the legislation, and with recent seats gained by the Green and Socialist parties in the European Parliament, it is likely we will see traditionally conservative leaders moving towards the political centre, aligning policy to a 2°C scenario.

3. Reaching carbon neutrality

Ursula von der Leyen, President of the European Commission, is calling for an acceleration of decarbonisation, reducing carbon levels to 50% of 1990 levels by 2030, on the way to reaching carbon neutrality in the EU by 2050. Simply stating the ambition to reach carbon neutrality by 2050 would be meaningless without interim steps to ensure success. In order to prevent irreversible environmental degradation, she has proposed converting parts of the European Investment Bank (EIB) into a climate bank, where she has plans to unlock over EUR 1 trillion to fund business transition to carbon neutrality in the transport, real estate and energy sectors.

It is early days and the EU taxonomy still needs to be passed by the European Parliament, but with the European Commission supporting the legislation, and with recent seats gained by the Green and Socialist parties in the European Parliament, it is likely we will see traditionally conservative leaders moving towards the political centre, aligning policy to a 2°C scenario.

Major challenges

One major challenge is the huge range of metrics that can constitute a social issue, including labour relations, workforce diversity, procurement and supply chain practices. Even when a relevant social factor has been identified, it can be hard to measure its impact. For example, does education provide a social benefit if it is a private education for wealthier children?

And unlike environmental measurements, such as reducing carbon emissions, social indicators often lack a clear start and finish point. A company may be employing people in rural areas where work is scarce, but the question then becomes: is it employing both men and women? And is it paying them a low wage or a living wage? Is it providing fringe benefits? The questions are endless.

The qualitative nature of many social programmes makes it difficult to translate them into meaningful key performance indicators that can be used effectively by investors.

The social imperative

Regulators, exchanges and investors are successfully demanding that companies provide more and better data on social factors. Many initiatives are slowly making progress. For example, the UK’s Modern Slavery Act 2015 requires large and mid-sized companies to set out the steps taken to ensure that modern slavery is not taking place in their business or supply chains.

Another step forward is the Sustainable Stock Exchanges Initiative, a UN working group and forum for exchanges to use ESG reporting to support the ESG reporting of their member companies. Since 2015, when the initiative called on all exchanges to provide guidance on ESG reporting, the number of exchanges doing so has more than tripled to 43.

Technology also has a role to play. For example, some companies are partnering with local NGOs to use satellite imagery to check that suppliers are not supplying false data on the use of child labour. Further developments are well placed to gather, analyse and aggregate publicly available big data on the securities they hold on behalf of investors. And this is what investors are demanding. In BNP Paribas’ ESG survey, 36% of respondents saw ESG data aggregation as the most important ESG service provided by a custodian, and 43% regarded analytics and risk monitoring as a key custodian service to support ESG investing.

Progress on supporting the S in ESG is welcome and, although information on social performance is far from perfect, institutional investors can challenge data vendors and companies to speed up progress. *-*
GOVERNANCE: TOUGH TO ASSESS FROM THE OUTSIDE

A constructive and investment-focused approach to company engagement has helped AMP Capital gain a clear picture of governance across its equity portfolio, says Karin Halliday, its Senior Manager, Corporate Governance.

Governance is seen as a key factor in driving company value – not because well-governed companies will always outperform, but because poorly-governed companies are more likely to underperform. Time and time again we have seen evidence that the companies most likely to fail are those riddled with conflicts of interest, incompetent or disengaged directors, poor culture or poor risk oversight.

AMP Capital’s interest in good governance started early. As one of Australia’s largest fund managers, we naturally held a broad range of companies across our equity portfolios. Inevitably, not all those companies were well governed.

As we couldn’t just sell every company that lacked an effective board or a reasonable pay or risk-management structure, we instead embarked upon a programme of constructive engagement.

It was many decades ago that we first committed to deeply understanding the governance structures of the companies we held and to engaging with those companies when questions or concerns arose.

As the issues are not always resolved in the first instance, we then choose whether to continue the dialogue, use our voting power to further influence change or, as a last resort, divest from the company. Ultimately, the course of action we take will always depend on our clients’ mandate and what we consider to be in their best interests.

The governance mosaic
While financial losses can often flow from problems associated with poor accountability, fraud or misconduct, determining the quality of a company’s governance from the outside is not easy. It takes work.

When you are dealing with intangible factors – integrity, cognitive diversity, accountability and trust – governance, or broader ESG research, becomes much like constructing a mosaic. Individually, the pieces may contain little value but the more of the right pieces you have, the more likely you are to be able to construct a true and clear picture.

Traditional governance data points include: a separate CEO and board chair; the percentage of female directors; director attendance records; the ratio of non-audit/audit fees; the level of voter support for pay; and a whistleblower policy. These data points are easy to collect. While they may be interesting, they only show part of the picture. Only with further information and insights can investors truly understand the level of independence and alignment with shareholder interests, the cognitive diversity and inclusion, director diligence, integrity of financial reporting, fair and effective pay structures, and employee protections.

The picture becomes clearer when each company’s response to its environmental and social risks and opportunities is also considered. AMP Capital found that by virtue of our large shareholdings, and our constructive and investment-focused approach to company engagement, we were given unrivalled access to company boards.

Through meeting board members, investors learn what drives a company. The insights gained about material ESG risks and opportunities enable us to better assess a company’s potential for generating sustainable returns over the long term.

A lot can be learned about a company’s governance and priorities by also looking at its actions around pollution, safety and responsible sourcing. For a company’s economic growth to be sustainable, its actions cannot have a negative impact on the social, environmental and community relationships in the areas in which it operates.

While some argue that it’s easier to analyse G than it is E or S, I haven’t found that to be the case. Not only is it difficult to judge a company’s governance from the outside, but governance also impacts on everything a company does.

Well-governed companies get everything right – strategy, culture, management, succession planning, innovation, risk management. Ultimately, those companies understand how to leverage and protect their financial capital, as well as their environmental and social capital.

CURRICULUM VITAE
Karin Halliday
Karin Halliday became Senior Manager, Corporate Governance at AMP Capital in 2000. She spent the previous ten years in portfolio management. She says she has not tired of governance; if anything, she’s more passionate about it than ever.
INTRODUCING CORTEX LIVE

BNP Paribas unveils Cortex Live, featuring ALiX, a personal digital execution assistant to guide clients through every step of their execution

www.aboutglobalmarkets.bnparibas.com/cortex-fx
MEET JENIFFER KITHURE

Jeniffer Kithure (pictured below) is a widowed mother of four. Her husband was attacked on his way home from work and died from his injuries. In 2005, having no formal income to her name, Kenya-based Kithure began working in a tree-planting programme.

The programme helps small groups of subsistence farmers to improve their local environment through afforestation – i.e. planting and maintaining trees on degraded and/or unused land. Carbon captured by the trees is quantified and verified. Certified carbon offsets are then sold in the global voluntary carbon market. Farmers receive annual carbon pre-payments for each tree, plus 70% of the net profit when the credits are sold.

Kithure has gained economic independence and flourished as a leader in her community. Today, she is part of the programme’s Operational Leadership Council and mentors women who join the programme. Within Kenya, this programme has given 25,000 women the chance to earn their own income for the first time in their lives.

About ClimateSeed

ClimateSeed is one channel through which the afforestation project can promote its carbon credits. ClimateSeed is a social business owned by BNP Paribas. It offers a digital platform that connects sustainable projects with organisations wishing to voluntarily offset their carbon emissions. Programmes supported by ClimateSeed not only help avoid or capture CO2 but also contribute towards the Sustainable Development Goals set by the United Nations.

To learn more about this and other projects, visit climateseed.com
private equity funds are increasingly aligning their portfolios with Environmental, Social and corporate Governance (ESG) considerations. They are recognising the material value brought by sustainable businesses and are integrating ESG into their investment processes. Consequently, we have seen an increase in the launch of impact funds, along with KKR’s early commitment to fully embed ESG considerations throughout its investment process.

During the US presidential election in 2008, the partnership was the first of its kind between a private equity firm and an environmental organisation focused on finding solutions to environmental problems – in 2008 and we have been building on the lessons learned ever since. The ‘Green Portfolio’ partnership with EDF – now called the Green Solutions Platform – was set up to measure and improve the environmental performance of companies across our portfolio. As part of that, we committed to developing a set of analytics tools for companies to use to assess and track cost-effective improvements on a series of environmental metrics. In 2008, the partnership was the first of its kind between a private equity firm and an environmental organisation, and we wanted to bring the rigorous approach of private equity management to the area of environmental performance.

Q: How long has KKR been focused on sustainable/ponsible investing? It’s been over a decade since we formally began our responsible investment journey and developed a team and started building resources. We announced a partnership with the Environmental Defense Fund (EDF) – a US-based non-profit organisation focused on finding solutions to environmental problems – in 2008 and we have been building on the lessons learned ever since.

The ‘Green Portfolio’ partnership with EDF – now called the Green Solutions Platform – was set up to measure and improve the environmental performance of companies across our portfolio. As part of that, we committed to developing a set of analytics tools for companies to use to assess and track cost-effective improvements on a series of environmental metrics. In 2008, the partnership was the first of its kind between a private equity firm and an environmental organisation, and we wanted to bring the rigorous approach of private equity management to the area of environmental performance.

Q: What does that mean in practice? How do you integrate ESG throughout your portfolio? Honestly, it’s always a bit of a moving target and we’re always seeking to evolve and to do more. As it relates to our private equity strategies, in the past decade we have engaged with hundreds of companies across various geographies and asset classes on issues ranging from environmental impact and responsible sourcing to worker safety and employee wellness, among many others. We have expanded our due diligence practices and reporting processes, responded to countless investors and helped shape a smarter way forward for our firm and, hopefully, our industry. In general, we are committed to the thoughtful consideration of relevant ESG issues throughout the investment process in a way that is integrated and materiality-driven.

Q: In 2018, you launched an impact strategy. What drove this decision? As I’ve mentioned, KKR has put in place strategies for thoughtfully managing ESG and stakeholder issues as a way to reduce risk and create sustainable value. We have also invested in companies where the core business model, product or service provides a solution to an ESG-related challenge and produces strong financial outcomes alongside positive impact. We have made more than 30 such investments totalling over USD 5.5 billion in KKR fund equity since 2010. After seeing many investment opportunities around these themes in the lower middle private equity market – a corner of the market that we believe has been underserved – in 2018 we launched KKR Global Impact, which is an impact investing business focused on tackling problems across the globe where KKR operates. By creating a dedicated strategy, we are better positioned to identify great opportunities, particularly in the lower middle private equity market, and to help these sustainable businesses grow.

Q: What measurement does KKR use to evaluate the impact on its investments? We’re committed to measuring and reporting the impact of KKR Global Impact in a manner that is transparent and leverages established frameworks. For this strategy, we evaluate, measure and track each portfolio company’s contributions to one or more of the United Nations Sustainable Development Goals using indicators defined by third-party reporting frameworks wherever possible. We work with the management teams of portfolio companies to design and implement the appropriate processes to gather the necessary data. In addition, as part of our effort to align with credible third parties, in 2019 we became founding signatories of the Operating Principles for Impact Management, developed by the International Finance Corporation, part of the World Bank Group. We intend to measure and communicate our progress towards aligning with these principles.

Q: What do you see as the main barriers to further integration of ESG? Our work is always evolving to keep up with emerging trends and expectations. Even today, there’s a lack of information for investors to make decisions, at least partly driven by companies and investors not knowing what is most important and how to get and interpret that data. This is one reason we have worked to integrate the market-driven standards of the Sustainability Accounting Standards Board in our processes. There’s more work to do to get to the point where we have all of the information we all need.

Q: You can play an important role in helping to reduce carbon emissions. What are you doing in this area? We measured our own emissions in 2019 and are working on strategies for how to manage that going forward. We have also worked for many years to support our portfolio companies’ efforts to manage and reduce emissions and are currently working on evaluating additional strategies aligned to the Task Force on Climate-related Financial Disclosure. One of the things we’ve done to date is launch the KKR Eco-Innovation Award to encourage and reward KKR portfolio companies for innovative, environmentally beneficial projects or initiatives that create business value.

Q: Have you seen any noteworthy trends from your limited partners (LPs) in regard to this agenda? We have learned a lot in partnership with our investors over the past ten years and appreciate their ongoing engagement and feedback, such as the ones we get via our partnership with BNP Paribas. I think that LPs have a unique perspective and ability to educate their investment managers on what practices they have seen that are effective. We are always open to learning about proven practices and partnering with others.

For more on KKR’s ESG strategy visit kkr.com
INITIAL MARGIN: A PAUSE TO PREPARE

The decision to delay full implementation of margin requirements for non-centrally cleared derivatives has been welcomed by the industry. Not only does it avoid a last-minute rush to comply, it represents an opportunity for firms to rethink their approach to derivatives and collateral management.

In July 2019, the Basel Committee and the International Organization of Securities Commissions (IOSCO) agreed to a one-year extension to the final implementation phase of the initial margin requirements for non-centrally cleared derivatives. These requirements are designed to reduce systemic risks related to over-the-counter (OTC) derivatives markets, as well as to provide firms with appropriate incentives for central clearing while managing the overall liquidity impact of the requirements.

Under this extension, covered entities with an aggregate notional amount of non-centrally cleared derivatives that is greater than EUR 8 billion (phase six firms) become subject to the requirements from 1 September 2021. Meanwhile, the 1 September 2020 deadline remains for phase five firms, but with the threshold increased to EUR 50 billion.

David Beatrix, Head of Product for Collateral Access at BNP Paribas Securities Services, describes these delays as a sensible response to concerns that firms, especially buy-side ones, were not prepared for the impact of the new rules. “At the root of this reform is a desire to move from a ‘survivor pays’ principle, to a ‘defaulter pays’ principle, to avoid firms using their own capital to absorb losses implied by a counterparty bankruptcy. Another effect is that this will also promote central clearing,” he explains. “There is a realisation on the part of the Basel Committee and IOSCO that initial margin (IM) compliance is not just a copy-and-paste of the variation margin (VM) process; it is a new process with a steep learning curve.”

The margin requirements for non-centrally cleared derivatives are broadly aligned across North America, Europe and Asia Pacific, although there are nuances with regard to exemptions. For example, equity options are out of the scope of margin requirements in the US rules, but were only exempted in the European Union up until 4 January 2020.

Who’s affected?

Among the buy-side community, asset owner institutions (particularly insurance companies, pension schemes and sovereign wealth funds) are expected to be most affected by the changes because of the size of their derivatives positions and their consolidation under one single entity, says Beatrix. Asset managers will only be impacted if they have delegated mandates from asset owners or if they manage funds that use OTC derivatives above the EUR 8 billion threshold, which remains rare.

Furthermore, when asset owners delegate the management of their assets – usually across multiple managers – they also often delegate middle and back office functions. This can make it challenging to calculate initial margin due to the potential for fragmented calculations across multiple managers.

“We have already had discussions on this topic with clients who are tempted to replicate what they already do on variation margin – in other words, to leave their investment managers to manage the variation margin independently from each other,” Beatrix adds. “This works well for variation margin because numbers are additive, but initial margin is a risk-based calculation and, as such, fragmenting the calculation process can involve higher IM amounts once cumulated across investment managers.”

Collateral optimisation

Another issue on which BNP Paribas Securities Services can guide clients is collateral optimisation. The market is concentrated around securities as collateral, but many phase five and phase six firms do not necessarily own large volumes of these assets so may have securities that are not considered eligible by a counterparty.

Jérôme Blais, Head of Business Development and Client Solutions, Triparty Collateral Management at BNP Paribas Securities Services, observes that, although cash is acceptable according to the regulations, counterparts prefer not to have cash left on the books of their custodian.

“We are working with firms to combine custodial and collateral management services with collateral transformation,” he says. “This means that when clients require high-quality liquid assets, they can institute an order to our trading desks to convert less liquid or less highly rated assets into high-quality assets to be posted to their counterparties.”
In addition, we are helping those who find it challenging to fully implement initial margin rules by calculating initial margin amounts using industry standards and connecting to market utilities, which are key to margin and portfolio reconciliations,” says Beatrix.

Testing ideas
Blais explains that firms are increasingly viewing his team as a resource where they can test ideas. “We have been spending an increasing amount of time this year supporting clients as they determine the most effective model for their business, whether that is triparty, using an outsourcer for collateral management or developing their own system in-house,” he says.

“This is also why we made the strategic decision to invest in a triparty collateral service, which has created the fifth global offer on the market. This was a sensible move given that, in Europe, triparty now accounts for more than 95% of initial margin.”

Critics’ concerns
Inevitably, the new margin requirements have not been universally welcomed. “While the objectives are praiseworthy, we must also recognise that they don’t address demands to raise the thresholds to avoid having so many counterparties becoming subject to margin requirements,” says Blais.

There is also some concern around possible future treatment of cross-currency swaps. The Basel Committee and IOSCO have said they will evaluate the risks of not subjecting the fixed physically settled foreign exchange transactions associated with the exchange of principal of cross-currency swaps to the IM requirements.

Then there is the cost factor. The buy-side often seeks a directional position to hedge risk or take a specific view on some assets or groups of assets, which could imply some significant IM numbers.

As a result, in many cases, posted collateral implies a net funding cost, which cannot be compensated with collateral received, as the latter is simply not reusable.

Industry standard
“Most of the industry has opted for the SIMM or standard initial margin model because it recognises risk offsets, which is an important factor for banks and for the industry as a whole. It implies that if you have a market risk-neutral portfolio, the initial margin numbers are going to be lower, which will minimise funding costs,” says Beatrix.

He also refers to firms taking the opportunity to review their roster of service providers. “They may have realised that they have a reason to take a strategic look at their service model and implement a more streamlined approach across the entire chain of services.”

While phased implementation of the final stage of the new margin rule should reduce the incidence of rushed implementations, it is vital that buy-side firms continue to push ahead with their compliance planning. Reorienting derivatives activity is not achieved overnight – it requires months of careful planning.
In this article from BNP Paribas Securities Services’ Dear COO series, Fiona Mulligan, Global Hedge Fund Product and Solutions Manager, looks at the evolution of the hedge fund investor and how managers are adapting to meet their shifting requirements to attract and maintain capital.

Our industry is at an inflection point.

Having worked on the investor services side of the hedge fund industry for almost 20 years – including for a USD 20 billion-plus London hedge fund and in my current position leading Investor Services Product for BNP Paribas Hedge Fund Services globally – I’ve seen the sector evolve considerably since the turn of the century. Unsurprisingly, spurred on by rapid digital innovation, the pace of this evolution is quickening. Hedge funds now face an increasingly challenging environment for raising assets, with evolving market dynamics and increasing regulatory requirements giving the COO much to ponder.

However, we are also seeing a marked shift in the expectations of the modern
are proving to be very effective and co-investments in particular structures. Managed accounts family office, co-investment for tailored products is through One of the ways hedge funds have alternatives customised portfolios. and ability to facilitate such also their core infrastructure fund managers to not only bespoke structures, prompting the shelf' strategies towards more a divergence from traditional 'off capital. As a result, there has been meet their evolving needs is vital the future and hedge funds are little sign of abating in the near the tailor-made trend is showing alternative assets is on the up – Asia, a region whose appetite for giving rise to a burgeoning pocket tap an increasingly savvy retail accessing will be a source of competitive advantage for fund managers who are committed to the digital transformation of their infrastructure. Doing so not only yields efficiency gains, but also helps cultivate a reputation for putting clients first.

"Hedge funds now face an increasingly challenging environment for raising assets, with evolving market dynamics and increasing regulatory requirements giving the COO much to ponder"

predicted to continue to diversify their products in a bid to raise and retain assets.

But there’s a catch While such flexibility positions a manager favourably in the eyes of the allocator, there is no doubt that offering a diversified product range brings with it added operational burdens and costs that will hit the COO’s desk. Existing processes, IT infrastructure and/ or legacy systems often require investment to support the new products while at the same time meeting investor servicing expectations. These infrastructure and distribution challenges are increasing the dialogue with service providers and positioning those with a global front-to-back, traditional UCITS – as well as other core alternative services – expertise to the fore, allowing COOs to address their full range of challenges under a single relationship. Compounding the issue is the greater scrutiny being placed on a fund manager’s fee structure, which also adds a layer of operational complexity. Following the publication of the Albourne Partners’ white paper in December 2016 – Case Study: The Texas Teachers’ “1-or-30” Fee Structure – we are seeing this methodology gaining the attention of both managers and investors. The structure guarantees that the investor will pay the hedge fund a 1% management fee, regardless of performance, but will never pay more than 30% of the alpha provided annually by the fund. If you are considering diversifying your product offering or adapting your fee structure, working alongside your fund administrator to map out the best course of action is a worthwhile exercise. By leveraging their specific expertise and scalable infrastructure, you can take their operating model and fund managers with the flexibility and innovation to respond to this will be poised to reap the rewards. As this dynamic continues to evolve – and looking ahead to the impending shift in the demographic profile of the end investor – a streamlined user experience and data accessibility will be a source of competitive advantage for fund managers who are committed to the digital transformation of their infrastructure. Doing so not only yields efficiency gains, but also helps cultivate a reputation for putting clients first.

A streamlined user experience and data accessibility will be a source of competitive advantage for fund managers who are committed to the digital transformation of their infrastructure. Doing so helps cultivate a reputation for putting clients first.”

“Hedge funds now face an increasingly challenging environment for raising assets, with evolving market dynamics and increasing regulatory requirements giving the COO much to ponder”

an end-to-end view of your operations to optimise processes and minimise fixed costs. To the extent that they are equipped to service the full spectrum of asset classes, they will also be able to assist in creating the end-to-end product lifecycle and manage the entire corporate action process to ensure a smooth transition for both you and your investors.

Putting the ‘service’ in investor services

Lastly, it’s also important to consider the bespoke investor requirements when it comes to service delivery. One size does not fit all. Today’s fund manager must be attuned to the differing preferences of its institutional and high net worth individual (HNWI) investors alike, as well as its distributors. Today’s HNWI allocator is increasingly sophisticated and expects a very different relationship with the manager and the service provider. They want online access to their data and reporting made available through familiar digital channels like mobile apps. On the other hand, a growing proportion of institutional investors and distributors are seeking big data integration via application programming interfaces (APIs) and file sharing from the manager and service providers, which can feed into their underlying technology solutions. Automation and straight-through processing (STP) are at the forefront of their operating model and fund managers with the flexibility and innovation to respond to this will be poised to reap the rewards.

As this dynamic continues to evolve – and looking ahead to the impending shift in the demographic profile of the end investor – a streamlined user experience and data accessibility will be a source of competitive advantage for fund managers who are committed to the digital transformation of their infrastructure. Doing so not only yields efficiency gains, but also helps cultivate a reputation for putting clients first.

A final word

In addition to improved efficiency and scalability, adaptability is increasingly core to a service provider’s proposition to a fund manager. Faced with ongoing change at the market and investor level, the ability to adapt the product offering and underlying infrastructure is becoming crucial for today’s COO. To ensure successful fundraising in the years ahead, a fund manager will need to be able to keep up with its allocators’ demands, while still dedicating adequate resources to alpha-seeking activities.

With best wishes for your future success,

"A streamlined user experience and data accessibility will be a source of competitive advantage for fund managers who are committed to the digital transformation of their infrastructure. Doing so helps cultivate a reputation for putting clients first."
Cryptography is omnipresent in our daily lives, securing our mobile & network communications and protecting transactions. Advances in quantum computing could threaten the security of at least some of this data in the next few years so companies – and countries – need to be prepared for change. Here, Aline Gouget, a cryptography adviser at Thales, speaks to Quintessence about post-quantum cybersecurity.

Q: First, could you tell us about your job?

I’m in charge of advanced cryptography in the Digital Identity and Security business at Thales. I act as a bridge between research and industry for advanced mechanisms that could be used in the future in, for example, data protection. I look at the constraints associated with these mechanisms and how they could be integrated into real life.

My priority is to understand advances in cryptographic attacks and what impact they might have on products and solutions, both now and in the future. We need to understand how safe the cryptographic algorithms we use are, and for how long they will remain safe. Even data that already exists may require protecting for longer than the product in which it is contained remains secure. So we need to be prepared, to be able to change cryptographic mechanisms and become ‘crypto-agile’.

I also work on new cryptographic mechanisms like homomorphic encryption, which...
allows calculations to be made on encrypted texts known as ciphertext, looking at how these mechanisms can be used industrially.

Q: What are the advantages of quantum over traditional calculation?
Quantum computing can speed up calculation in certain cases, using what we call the superposition of states: the bits that make up a quantum computer, qubits, can exist in two equivalents, can exist in two states at the same time.

Q: Are you involved with this?
I’m a cryptography specialist rather than a quantum specialist and I don’t like to make predictions. Also, after discussing this with specialists, there doesn’t seem to be a consensus.

Until recently quantum computing was an idea, a dream. Now we have passed that stage and the problems that remain are in the realm of engineering. There is still some way to go. While several thousand qubits would be needed to endanger encryption, for the moment the biggest existing machine is a 72-qubit machine built by Google in 2018.

Q: So when do you think quantum computing might become a threat?
I’m a cryptography specialist rather than a quantum specialist and I don’t like to make predictions. Also, after discussing this with specialists, there doesn’t seem to be a consensus.

Q: Does everyone have the same requirements regarding cryptographic security?
Government agencies make recommendations on security – for example, on the size of the ‘key’ that is used to encode data – especially when a company wants to certify a product. Different companies can also set different recommendations, for example, companies like Visa and MasterCard use a standard known as EMV. Companies also keep an eye on new developments in others’ recommendations, which helps them see what might need updating.

Q: What about positive uses of quantum technology?
There are projects looking into how quantum-related areas that are not included in NIST’s scope, for example, quantum key distribution. This technique, which provides a way to distribute and share secret keys that are necessary for cryptographic protocols, is not new – it has been commercially available for several years – but is increasingly being talked about today. Quantum sensors – quantum devices that respond to stimulus – is another area that is being explored, particularly in terms of how they might be used in the future.

Until recently, quantum computing was an idea, a dream. Now we have passed that stage and the problems that remain are in the realm of engineering.

Several thousand qubits would be needed to endanger encryption; for now, the biggest machine is 72 qubits.

Several thousand qubits would be needed to endanger encryption.

By Aline Gouget

Aline Gouget is a Cryptography Adviser at Thales, a French aerospace, defence, transport and security firm. She focuses on topics such as white box cryptography, applications of blockchain, homomorphic encryption and quantum cryptography.

Aline Gouget was speaking to BNP Paribas following a presentation she made to BNP Paribas’ Women in Business club at the VivaTech innovation gathering in Paris, May 2019.

The EU Quantum Flagship is a vast project that is complementary to the work done by NIST and looks into the different uses of quantum technologies – unlike NIST, which is looking into what we need to do, assuming a quantum computer becomes available.

This article originally appeared on cifdocs.com.

Aline Gouget was speaking to BNP Paribas following a presentation she made to BNP Paribas’ Women in Business club at the VivaTech innovation gathering in Paris, May 2019.
Harnessing the power of APIs

The challenges of interoperability and complexity, along with the search for efficiencies, are well documented in our industry and, although APIs may not be a silver bullet, they can provide a powerful tool to allow securities services providers to deliver increased value to clients if adopted effectively.

First, we can look at the volume of data exchanged between organisations in the post-trade industry and the increasing need for information to be made available in near real time. Many large firms, including BNP Paribas Securities Services, have invested in the underlying building blocks to aggregate and deliver data. They have optimised data governance, quality, lineage and security, putting firms in an ideal position to leverage APIs to unlock data in real time.

The challenges that come with the growth in complex asset classes have provided the need for new data feeds to facilitate this expansion. While, in the past, technological change could not always keep up with growth, service providers are now better placed to deliver on new data requirements in a flexible, efficient and timely manner – ultimately helping to reduce risk for clients.

The old joke is ‘Faster, better, cheaper. Choose two of the above’. In the securities services industry, we are seeing a real drive for efficiencies, improved customer experiences and faster processing times. While significant progress has been made to improve STP (straight-through processing) rates and reduce breaches through the use of robotic process automation, artificial intelligence and machine learning, there are still process areas that rely on traditional phone and fax for information exchange. System-to-system communication and real-time status updates via APIs provide a potential low-cost route to further enhance efficiency while delivering improved experiences to customers.

Collaboration is key

The API programme at BNP Paribas Securities Services has been developed by working hand-in-hand with our clients. This has ensured a strong focus on delivering real solutions to our clients’ key pain points. To date, we have prioritised our API investigation and delivery in areas such as NAV (net asset value) calculation and distribution, settlement instruction and settlement status, and corporate actions, as well as exploring how APIs can help with regulations such as the Shareholder Rights Directive II and Central Securities Depositories Regulation.

Of course, driving product or technology innovation within the confines of a single business is one thing. Creating a sensible framework allowing these technologies to obtain mass market adoption is an altogether different challenge. If emerging or disruptive technologies are to achieve scale, they will need to be underpinned by the same levels of security and resilience as existing channels, and adhere to robust, albeit flexible, standards.

At present, client access to data at their various counterparties is not homogenous, meaning users receive proprietary information in multiple, unique formats. This adds to customer costs, complexity and risk, acting as yet another barrier to achieving interoperability. In a recent BCG survey of asset managers, 70% of respondents said that they were concerned about API interoperability when exploring API solutions with their providers.

Setting the standard

Only through a single, industry-wide API standard will the benefits of this technology be fully realised. Standardisation will outline the principles, methodologies and data definitions covering the ways in which information is exchanged or relayed across clients and their service providers. A standardised set of rules will help reduce the risk of inaccurate data being disseminated while simultaneously streamlining the procedures by which firms collect, aggregate and use data. Such standards must also include guidelines covering data governance so as to ensure that APIs comply with global regulations and rules.

Any harmonisation of API standards will undoubtedly accelerate with the involvement of organisations such as SWIFT. SWIFT has played an instrumental role in promoting standardisation across global securities markets over the past few decades, most notably in its efforts in supporting the delivery of uniform financial messaging standards through ISO 20022. In fact, SWIFT is already involved in API standardisation discussions, having recently published a blueprint for common API standards following engagement with various European banking standards bodies, STET and NextGenPSD2.

To this end, BNP Paribas Securities Services is already partnering with SWIFT to standardise our API catalogue to ISO 20022 as a first step to help drive API standardisation.

What comes next?

APIs have the potential to significantly transform current market practices and the way our industry processes data and provides services. However, unless API processes undergo standardisation, the sharing and use of data will continue to be inconsistent and open to misinterpretation.

The establishment of an API standard will be dependent on the industry working together. Assuming this industry consensus can be reached, API technology will become even more ingrained in the securities services ecosystem and has the potential to unlock new value for all participants. The tech giants have proved the use case for API adoption, now it is the turn of our industry to work together for the benefit of all our clients.


**IT’S A BLOCKCHAIN REACTION FOR ASIAN STOCK EXCHANGES**

Stock exchanges in Asia Pacific are powering ahead with blockchain, but there’s a need for genuine collaboration to ensure that the end user benefits from its full potential, writes Luc Renard, Head of Financial Intermediaries & Corporates Asia-Pacific for BNP Paribas Securities Services.

In recent years, stock exchanges have been adapting to the changing landscape of financial markets. As cost pressures and the need for new, speedier ways of trading and augmenting practices intensify, blockchain, or the distributed ledger technology (DLT) underpinning it, has been vaunted as a potential solution to the challenges facing securities markets.

The complexity of a real-time delivery versus payment (DVP) model, which is a necessity for some regulated fund products such as Undertakings for Collective Investment in Transferable Securities and Alternative Investment Fund Managers, increases settlement risk and funding cost.

Right now, across Asia Pacific, a number of potentially pivotal developments are taking place in the trading and post-trade space, with stock exchanges rapidly gaining ground on the adoption of blockchain, integrating the technology into their core systems and activities.

**ASX leading the charge**

The Australian Securities Exchange (ASX) has been an early mover when it comes to blockchain innovation, announcing that its 25-year-old Clearing House Electronic Sub-Register System would be replaced with a DLT solution. Designed to offer international investors easier access to Chinese A-shares, Stock Connect has encountered some issues that have prevented institutional investors from taking part. Investors trading China A-shares via Stock Connect currently only have a four-hour time window to settle their transactions, forcing institutions to pre-fund their trades, thereby exposing them to settlement risk.

The ASX has partnered with Digital Asset Holdings to create a working prototype for cash equities clearing and settlement processes. BNP Paribas Securities Services has participated in the working group for this transition programme over recent years.

The ASX has confirmed that it will go live with DLT in March–April 2021.

**HKEX turns to blockchain**

Unlike the ASX’s move to adopt DLT enterprise-wide, Hong Kong Exchanges and Clearing (HKEX) is working with Digital Asset Holdings and BNP Paribas to enhance its post-trade infrastructure. This is aimed more specifically at accelerating the processing of northbound transactions on Stock Connect, which links the HKEX bourse with its counterparts in Shanghai and Shenzhen.

**“Stock exchanges will continue to leverage blockchain technology, which can bring about major improvements in securities trading for end investors and intermediaries”**
Connect. Therefore, a number of leading providers, including BNP Paribas, have developed integrated broker-custodian models or special segregated account structures to facilitate real-time DVP for clients. BNP Paribas and HKEX have been working extensively to further improve the process.

HKEX is developing a prototype solution to enable market participants to specify their settlement workflows in advance, helping to bridge time zones, while allowing for real-time synchronisation of the post-trade status between asset managers, brokers, custodians and the Hong Kong Securities Clearing Company, HKEX’s central counterparty clearing house. It is hoped that this DLT solution will help increase foreign investor flows through the Stock Connect access scheme.

The simultaneous exchange and settlement finality of digital assets and securities on different platforms vastly improves operational efficiencies during the course of the transaction. SGX and MAS are also assessing whether to automate the DVP settlement process through smart contracts, or self-executing, algorithmic legal agreements.

In March 2019, SGX and SWIFT announced their intention to trial a platform for e-voting based on blockchain technology. The proof-of-concept (POC) trial sets out to test a DLT voting solution involving issuers and a central securities depository, with data managed over a permissioned private blockchain. If successful, the platform could set a global standard for fund managers and corporate issuers.

"Stock exchanges are rapidly gaining ground on the adoption of blockchain, integrating the technology into their core systems and activities"

**Singapore improves its efficiency**
The Singapore Exchange (SGX) is also integrating blockchain technology into its core infrastructure alongside ASX and HKEX. In November 2018, SGX and the local regulator, the Monetary Authority of Singapore (MAS), confirmed they had successfully developed DVP capabilities for the settlement of tokenised assets across multiple blockchain platforms.

The prototype shortens the trade settlement cycle and reduces settlement risk. And the proliferation of blockchain POCs under way across banks, infrastructures and institutional investors has led to calls for securities markets to ensure that initiatives are harmonised as much as possible across organisations. The technology risks being developed in narrow, siloed ecosystems, possibly preventing future interoperability if firms don’t agree on universal standards and implement joint governance frameworks to underpin blockchain.

Just as SWIFT enhanced industry-wide efficiencies and reduced market risk by shaping the standards underlining financial messaging, leaders in the blockchain movement should define a similar approach. This could be done by integrating DLT with ISO 20022 or through an entirely new solution. A failure to find common ground on market standards could result in a blockchain that is too highly fragmented to deliver any real cost benefits for the end users.

**It’s only the beginning**
It is likely that stock exchanges will continue to leverage blockchain technology and pursue POCs, which could bring about major improvements in securities trading for end investors and intermediaries. Anticipated improvements could come in the form of lower trading costs and the removal of a number of the risks involved, and could lead to firms accumulating healthier returns.
COMPLIANCE: BANKS' NEW COMPETITIVE FRONT?

Compliance 2.0 needs to be about more than automation, says Stephanie Marelle, Global Head of Compliance at BNP Paribas Securities Services

During a recent Sunday family lunch, my father suddenly asked me: “In your job, you are in charge of verifying that banks follow their rules. Tell me, are they allowed to ask me all of these intrusive questions?” He handed me a substantial pack of paper – a suitability questionnaire, combined with updated Know Your Customer (KYC) documentation requests. Before I had time to explain that his bank was obligated to collect all of these documents for his own protection, he added: “You tell me that they do all this in order to know what they can NOT sell to me? That is totally mad!”

Anyone working in the financial world has similar anecdotes, prompted by a surge in regulation of all types.

In this emerging ‘new normal’ environment, an unexpected category of bankers has blossomed: compliance officers. These bankers are tasked with navigating hundreds of rules, protecting clients and the integrity of markets. Not only have their missions become more prominent, their number has increased by the thousands in a matter of a few years.

From its initial challenge of deciphering thousands of pages of new regulations, the compliance function’s effort is gradually shifting to implementing and processing information – a ‘Compliance 2.0’ phase. These processes are still largely labour-intensive.

When the banking industry has faced sudden surges in volumes of manual processes in the past, it has structured its response around three pillars: creating adequate market infrastructures; fostering common norms and standards; and focusing on automating processes.

All three steps seem very relevant again when discussing how to take compliance processes forward.

However, not all three pillars are being granted the same level of attention, with the automation of processes capturing most of it. It would be beneficial to the industry to progress the other two pillars. Although less fashionable, they are likely to be instrumental in achieving leaner compliance monitoring in the long term.

One such attempt is SWIFT’s KYC Registry, which went live in early 2019. This centralised register of KYC data and documents prevents every institution from having to establish multilateral processes to collect such data as and when needed.

Creating such an infrastructure required the whole industry to agree on a minimum set of rules and standards. To go further, local regulators will most likely need to converge towards international standards. Such a market infrastructure could extend beyond the fields of KYC to transaction surveillance more broadly.

These suggestions would help financial institutions enhance efficiency and the client experience. They would also help them optimise compliance costs, which can represent up to 15% of banks’ total spend. During the initial surge of new regulations, this was seen as a ‘cost of doing business’. However, compliance costs can be vastly optimised, notably by designing ‘end-to-end’ business processes that embed compliance checks.

In the new battle to restore competitiveness, there will be those that make it and those that don’t. Experience shows that those institutions embracing the challenge and taking a leadership role are often best placed to succeed.
When BNP Paribas Securities Services acquired client Janus Henderson Investors’ ‘40 Act fund operations activities in 2018, it was propelled onto the US mutual fund administration scene. Claudine Gallagher, Head of the Americas for BNP Paribas Securities Services, and Andrew Dougherty, its Americas Head of Asset Managers and Alternative Investors, discuss how they plan to offer the market a differentiated service focused on best-in-class delivery for clients, which will include a depth and breadth of services that only an integrated bank can provide.

Q: Why did BNP Paribas Securities Services decide to offer capabilities to service ‘40 Act funds?
Claudine: BNP Paribas Securities Services is the fifth-largest global custodian and we have a very strong presence in Europe and Asia Pacific. As we have ambitions to be the world’s premier securities services provider, we need to continue expanding our business in the world’s largest capital market – the US.
Andrew: Servicing ‘40 Act funds [pooled investment vehicles offered by a registered investment company, as defined in the US 1940 Investment Companies Act] is the next logical stage in our ten-year journey to grow our US business, which began in 2012 with the launch of our local and global custody offering.

Q: Tell us more about your acquisition of Janus Henderson’s mutual fund operations.
Andrew: The acquisition – or lift out – of Janus Henderson’s middle and back office operations included 140 of their mutual fund operations experts, who are now part of our ‘40 Act fund servicing team. Those professionals, based in Denver, Colorado, work across specialisations within IT, middle office transaction processing, and the core capabilities of fund accounting and administration. Importantly, this team was grown over decades from inside a global asset manager, which means they see the world in the same way as our clients. They bring a unique skill set to our servicing capabilities, which sets us apart in the fund administration sector.

Q: What type of clients are you targeting with ‘40 Act fund servicing?
Claudine: We have three target markets and these are heavily influenced by the trends that we are seeing in fund distribution, particularly asset managers wanting to diversify into different regions. We will focus on existing clients in Europe, Latin America and Asia Pacific that are targeting ‘40 Act franchises in the US, by providing them with a harmonised service across all asset classes and markets. The
第二目标市场是美国的国内资产管理人员。这个小组可能想扩大其业务范围到全球，但它在由独立金融服务提供商主导的市场中感到被忽视。作为回应，其首席执行官打算在ETF领域交付一个顶级的服务。

**BNP PARIBAS’ ETF OFFERING**

The US exchange-traded fund (ETF) market has grown by USD 1.8 trillion in just four years, according to research and consultancy firm ETFDLI, which means asset managers need services to keep pace with such fast evolution. Jefrey Baccash, Global Head of ETF Solutions at BNP Paribas, reveals how the Bank will deliver the latest support directly to asset managers’ fingertips

We have seen how important ETFs are for asset managers, not just in the US, which is the biggest market, but in other countries around the world. It makes sense, then, to develop a special ETF offering that will support the 40 Act fund servicing.

The ETF market globally is growing, but the development is inconsistent; not every jurisdiction is at the same stage as the US market. But that does not mean managers should accept inconsistency of service. BNP Paribas Securities Services has developed an offering that looks and feels the same regardless of jurisdiction and works seamlessly for ETF managers operating locally and globally.

We currently serve more than 200 ETFs registered in five different domiciles across the Americas, Europe and Asia. The consistency of our next-generation ETF platform is the result of extensive collaboration with asset managers, third-party consultants, technology providers and other members of the ETF ecosystem who want to domicile an expansion in a new market.

We are one of only a small handful of universal bank providers servicing ‘40 Act funds. This means we bring the entire Bank to our clients. We offer everything from fund administration and accounting to global and local custody, FX and agency securities lending. In addition, we can help with financing, capital markets and brokerage needs. These results in efficiencies for our clients.

**“We are on the only a small handful of universal bank providers servicing ‘40 Act funds. This means we bring the entire Bank to our clients”**

Andrew Dougherty, Americas Head of Asset Managers and Alternative Investors, BNP Paribas Securities Services

Italian custodian, BNP Paribas’ harmonised global service and expansive global network mean they can rely on our expertise in numerous jurisdictions as they expand into new geographies.

Andrew: BNP Paribas is one of only two service providers to claim a proprietary custody network covering the vast majority of our clients’ global investment funds. Our broad local custody network covers 26 of the largest markets and 90% of clients’ assets are within the BNP Paribas network. Again, that creates many market efficiencies because clients don’t need to use a local intermediary for asset protection.

**You have had a presence in the US market since 2012; how has BNP Paribas Securities Services’ business in the US grown over that time?**

Andrew: The nature of products is dramatically different from when we started. Following the Janus Henderson acquisition, we are truly full service. We deliver everything from custody and settlement to derivatives clearing, collateral management, securities lending, alternative and traditional fund services and loan administration.

The past few years have been about product development, building out our locations and hiring the right staff. We are now ready to provide a more robust offering to our asset manager clients.

**Which trends do you see in US fund administration?**

Claudine: Fund administration is driven by clients’ critical business issues. The glaring issue is the low interest rate environment, which is really pushing asset class diversification. So for fund administration that means offering better multi-asset servicing. Data, data management and analytics will continue to drive the business forward. Fee erosion coming from the passive side will continue straining fee revenues so efficiencies in the back office will be paramount, as will robust reporting. Interest in ESG continues to grow, as do products featuring ESG themes. And all things digital, cybersecurity and the ever-changing regulatory environment are no longer trends but facts of life.

**Andrew:** The growth of private capital and therefore the need to be able to service multi-asset classes will continue to increase. We’re seeing a lot of movement from asset managers adding to their product offering, especially on the private capital side, which in the next market cycle will have a greater influx of assets. Aside from that, the ETF market will continue to grow.
With the first Chinese company already trading on the Shanghai-London Stock Connect scheme, brokers are keen to understand the benefits of this new east-meets-west mechanism connecting two major stock exchanges. Here, we summarise the key points and insights from a BNP Paribas roundtable held in Shanghai in September 2019.

Shanghai–London Stock Connect is the latest in a series of initiatives designed to act as a bridge between China’s financial markets and the rest of the world. As the name suggests, it creates a two-way mechanism, with westbound and eastbound business. For the very first time, foreign companies are able to list in mainland China and directly access Chinese investors. Conversely, Chinese companies are able to raise funds overseas via London with instruments that are fungible with their domestic shares.

Launched in June 2019, the Shanghai–London Stock Connect creates a two-way mechanism, with westbound and eastbound business. For the very first time, foreign companies are able to list in mainland China and directly access Chinese investors. Conversely, Chinese companies are able to raise funds overseas via London with instruments that are fungible with their domestic shares.

As noted by Brian Schwieger, Global Head of Equities, Secondary Markets, London Stock Exchange Group, the new scheme demonstrates the UK and LSE’s commitment to Asia. “Shanghai–London Stock Connect represents one of the most important ways in which we are seeking to engage and partner with investors in China and Asia.”

**Cross-border issuance**

One of the major differentiators for Shanghai–London Stock Connect is that companies listed on the two stock exchanges can issue, list and trade depository receipts on the counterpart’s stock market in accordance with the corresponding laws and regulations. So far, eligible companies listed on the SSE can issue global depository receipts (GDRs) and apply for their listing on the Main Market of the LSE. This was put into practice in June 2019, when integrated securities group Huatai Securities became the first Connect issuer with USD 1.69 billion of GDRs on the Shanghai Segment of the Main Market of the LSE. This landmark issue allows international investors to access securities fungible with Chinese A-shares on an exchange outside China. Since its listing, Huatai’s GDR has already proved itself to be a liquid security, exceeding USD 1 billion of turnover at the beginning of September, said Schwieger, adding that around 25% of trading came from mainland Chinese and Hong Kong retail investors.

Working with brokers on a daily basis, Sabina Liu, Business Development Manager of Secondary Markets, London Stock Exchange, noted: “London’s trading hours sit between those of Asia and the Americas. With over 330 member firms globally, 14 of which are from Greater China, and with many more accessing through third-party brokers, London provides a unique opportunity for traders to trade outside their domestic markets and manage risks.”

In addition to the funds raised, Huatai gains broader benefits from listing on one of the world’s most international exchanges. LSE issuers operate in over 100 countries and the investor base is equally diverse thanks to its mix of local and global investors, along with institutional and retail money. “If a company trades in a pool of liquidity where all of the investors are retail, they will typically go in the same direction at the same time,” said Schwieger. “But if you...”
"It is the first time that foreign companies will be able to list in mainland China and directly access Chinese investors. It is also the first time that Chinese companies will be able to raise funds overseas."

"It is the first time that foreign companies will be able to list in mainland China and directly access Chinese investors. It is also the first time that Chinese companies will be able to raise funds overseas."

Custodians must develop structures that enable the smooth trading of securities between China and the UK.

With the first Chinese GDR trading, focus has shifted to which company will be the first to trade in the other direction.

"Companies are changing their models and structures, and not just using the structure they already had in place," said O’Brien. "A number of parties have either set up or are in the process of setting up entities within the UK market."

He described the broker-to-custody model, which is a way that a securities company can interact through a broker in the UK. That broker will work with their local agent to facilitate settlement into an investor’s account. The advantage of this structure is that it reduces the operational overheads associated with set-up, which a Chinese party might otherwise incur.

In addition to a relationship with a local brokerage, participants in Shanghai–London Stock Connect need to open an account with a custodian bank. The unique cross-border features of the Connect schemes can make the role of the custodian more important than in more standard market structures.

The different settlement times (T+0 in Shanghai and T+2 in London), for example, means that companies trading on Connect will want to review their hedging solutions and liquidity requirements. A custodian in the UK can help by offering securities lending services, said O’Brien, which is a service that Chinese brokerages might not be familiar with in their local market.

The future of Shanghai–London Stock Connect will depend on the active participation of all parties. The roundtable discussion showed that many Chinese brokers are reviewing their access solutions for the scheme, and are keen to see it succeed, but are not going to be able to provide an end-to-end solution without partnering with key experts in cross-border solutions. Custodians for their part will have to develop the structures to ensure that the securities can be traded smoothly between investors in both China and the UK. “Ultimately, an ecosystem of market participants will develop new capabilities and benefit from this connection between Shanghai and London for many years to come,” said Liu.
What is outsourced dealing?
Outsourced dealing is the use of a third party to place and process orders in the market with brokers/counterparties and trading venues. It can provide an alternative or extension to an in-house dealing function. The dealers had responsibility for routing orders to brokers or other execution venues with the goal of obtaining best execution as defined by their firm’s execution policy.

In recent times, the dealing role has evolved and become more sophisticated as new trading methods and venues have appeared. Notably, it has become less administrative and more specialist. However, not all in-house dealing teams have the capability to deal with the new world.

What about in-house dealing? Does that still exist?
Historically, investment managers had responsibility for the execution of orders, which they did by making a telephone call to a broker who then executed the order in the market.

As firms grew, technology improved and market infrastructure became more complex, leading to the introduction of order management systems (OMS) and a centralised dealing function. The dealers had responsibility for routing orders to brokers or other execution venues with the goal of obtaining best execution as defined by their firm’s execution policy.

In recent times, the dealing role has evolved and become more sophisticated as new trading methods and venues have appeared. The dealers have become more specialist. However, not all in-house dealing teams have the capability to deal with the new world.

Aren’t there some concerns about outsourced dealing?
You’re right. The market for outsourced dealing has been slow to develop. In the past, some of the concerns had been around a lack of confidence in providers, a misunderstanding of the services on offer and a lack of visible flagship clients to encourage interest and uptake.

Outsourcing: A new dawn for dealing desks?
Outsourced dealing services are increasingly considered an effective alternative, or a complementary service, to support internal dealing teams, says Thomas Castiel, Head of Dealing Services at BNP Paribas Securities Services.

In numbers: key findings from the BNP Paribas-Sionic survey of European investment managers

- 20% of firms have outsourced some or all of their dealing; all 20% were managing less than EUR 30 billion
- 21% of those firms that have not outsourced dealing say they will consider outsourcing in the next 18 to 24 months
- 44% of firms say supporting regulatory requirements is their biggest challenge
- 46% of firms say they would be interested in bundled services, including dealing, investment operations and custody

"The dealing role has become more sophisticated as new trading methods and venues have appeared. It has become less administrative and more specialist. Not all in-house dealing teams have the capability to deal with the new world."

Thomas Castiel
Thomas Castiel is Head of Dealing Services at BNP Paribas Securities Services, where he is responsible for defining global product strategy for Dealing Services and developing bundled solutions. He joined BNP Paribas in 2001 and has held various management positions in clearing and custody operations.

What outsourced dealing providers can offer to investment managers
- Cost efficiencies
- Help to meet best execution requirements
- Execution services for a range of asset classes across global markets
- Transaction cost analysis reporting
- Access to skilled dealing operations with advanced dealing techniques
- Comprehensive dealing infrastructure and execution management systems
- 24-hour dealing support
- Access to multiple sources of liquidity
- Enhanced negotiation benefits through higher dealing volumes
- Anonymised dealing
- Transaction reporting support
- Other bundled services such as middle office trade management and custody
More recently, we surveyed 30 investment managers across Europe about this issue in association with Sionic – a global financial services consulting firm. Our research shows that two factors are of particular concern today. The first relates to dealers being remote from investment managers, leading to a delay in communication between the two and a loss of control of the dealing process on the part of investment managers. The second relates to a reduction in market investment managers. The second relates to a reduction in market awareness by not having direct access to brokers.

However, outsourcing of services has moved up the value chain from repeatable, commoditised services to more complex and bespoke business processes based on high levels of knowledge and expertise.

**Q:** So, who is using outsourced dealing?

Initial adopters were hedge funds and start-ups, followed by asset owners who wanted to free their managers from execution without creating an internal dealing function. We now see investment managers looking to supplement their existing dealing operation with support in different regions. Interest and uptake are on the rise, especially among larger investment managers as the number of service providers is growing. More widely recognised outsourced service providers have fully established offerings, which bring greater confidence.

**Q:** How can outsourced dealing benefit clients?

Asset owners historically have not prioritised the costs of execution, implicit or explicit. However, all parts of the investment process are being reviewed to ensure clients get value for money from their investment managers due to increased fee pressures. Outsourced dealing is likely to be seen positively, especially if some of the cost savings are passed on in the reduction of fees.

**Q:** How should you go about selecting the right outsourcing provider?

The services offered by providers vary considerably in terms of asset class support, geographical presence, service models and payment methods. When selecting a provider, it is important to identify your key requirements for outsourcing, then shortlist and select a provider accordingly.

### The benefits of outsourced dealing

1. **Managing costs**
   - Key costs directly attributable to dealing are people, data and systems. Using an outsourced dealer alleviates a number of these costs, converting fixed costs into variable costs, reducing management overheads and execution costs. Firms with smaller volumes, and all the costs of systems and data for a three- or four-person team, are likely to find more cost advantages in outsourcing.

2. **24-hour dealing**
   - Some investment managers are looking for support in other time zones, as there is concern that leaving orders overnight with brokers in other regions might not achieve the best possible result. An outsourced desk will have greater awareness of its clients’ requirements, allowing it to make informed decisions, such as to cancel/amend an order given a news event/price shock.

3. **Reducing operational risk**
   - Responsibility for operational risks such as dealing errors – for example, entering an incorrect amount – lies with the outsourced dealers and is covered by their balance sheet and augmented by their insurance.

4. **Improved execution outcomes**
   - Outsourced dealing providers are likely to have a number of characteristics that improve execution outcomes, including:
     - Access to a highly skilled dealing operation
     - Larger scale, giving them greater negotiation benefits
     - Greater connectivity to a wide range of markets and venues
     - Access to wider and better liquidity
     - The ability to trade anonymously for a client in the market if required

5. **Regulatory support**
   - Since the 2008 financial crisis, there have been growing regulatory demands on investment managers, predominantly around best execution, pre-trade price transparency and post-trade reporting. Regulatory responsibility cannot be shifted to the outsourced service provider from the investment manager. However, outsourced dealing can substantially alleviate the regulatory workload.

6. **Keeping up with technological advances**
   - Dealing desks need to stay up to date with technological developments to compete in the market and to prevent erosion of alpha. Firms are starting to build portfolio analytics and trade simulation internally, but it is costly to maintain. Outsourced dealers, who need to invest in new technologies to remain competitive, are a cost-effective short cut to accessing technological innovation.
Eric Deudon, Global Head of Market and Financing Services at BNP Paribas Securities Services, shares his views on some of the changing dynamics in securities lending.

**Q: What are the current trends that you see in the securities lending market?**

Activity is particularly strong in Asia Pacific [APAC], bolstered by strong demand in some very dynamic markets such as Hong Kong. This is why we are further expanding our securities lending business in the region.

There continues to be robust borrower demand for eligible collateral securities and high-quality liquid assets [HQLA], especially for US Treasuries and European fixed income. This is being driven by regulations such as Basel III’s Supplementary Leverage Ratio, Liquidity Coverage Ratio and Net Stable Funding Ratio. As a result, the ability to lend out these assets on a term structure will remain highly sought after, even though spreads have recently been under pressure. Demand for HQLA is also being fuelled by regulation (i.e. Dodd-Frank) which mandates that financial institutions post good quality collateral as margin on their over-the-counter trades at either CCPs [central counterparty clearing houses] or bilateral counterparties.

Securities lending revenue linked to equities was lower than expected in 2019. The marginal slowdown in demand is primarily a result of the drop-off in mergers and acquisitions over the past two years, which saw global deal-making decline by 11% to USD 2.8 trillion. Meanwhile, exchange-traded funds [ETFs] as assets have driven strong interest, fully supported by ETF asset managers who are keen to ensure a high level of liquidity to facilitate the work of market makers and drive more flows into their programmes

**Q: How is regulation shaping the securities lending market?**

Regulation is a focus for market participants. Demand for HQLA will increase as the Basel III and IOSCO [International Organization of Securities Commissions] fifth and sixth waves of initial margin regulation come in over the next two years [see page 24 for further information].

Inside the European Union, the Securities Financing Transactions Regulation [SFTR] is due to go live in April 2020. SFTR is partly modelled on the European Market Infrastructure Regulation framework insofar as it insists that institutions engaging in securities lending and borrowing (plus repurchases or ‘repos’ and sell and buy-backs) practices disclose the details of their transactions to an ESMA [European Securities and Markets Authority]-approved trade repository. BNP Paribas is already providing support to clients as they prepare for SFTR [see page 56 for further information].

Elsewhere, the Central Securities Depositories Regulation [CSDR] is poised to introduce widespread efficiencies into the securities lending market by imposing mandatory buy-ins (where the lender recalls shares) and financial penalties for late settlements. Furthermore, operational efficiencies within lending programmes will become an increasingly important factor when pricing loans. Institutions that develop straight-through processing loan and recall processes will be net beneficiaries of the positive pricing premium versus those organisations that are less efficient.

Despite the benefits, new rules do of course generate costs for clients, and this is prompting institutions to outsource more of their operational activities.
and regulatory reporting requirements to their custody service providers.

**Q: What level of incremental revenue can institutional investors expect from engaging in a securities lending programme?**

The current historic low/negative interest rate environment, along with other challenging market headwinds, has made it harder for beneficial owners to ignore the added value that securities lending can deliver. Revenue generation from securities lending is ultimately determined by the nature of the underlying assets that an institution holds, but also the tenors (the amount of time remaining on the loan) and the collateral that will be acceptable. In terms of securities lending revenues, a stable portfolio can generate a wide range of returns, keeping in mind that the main revenue drivers will be specials, ETFs or HQLA on term. Furthermore, potential additional revenues can be accrued through the reinvestment of cash collateral, which will complement the intrinsic value obtained from the securities lending programme.

However, regulators are challenging asset managers regarding the proceeds that they generate from securities lending. Regulators want to ensure that the revenues are split fairly between the asset management arm and the fund itself.

**Q: Which are the main concerns of asset managers when engaging in securities lending?**

A proper governance framework is essential when entering into a securities lending programme, which means asset managers need to have full oversight and transparency of the activities being undertaken.

**Q: How are you enhancing your securities lending proposition?**

We offer principal and agency lending, a proposition that is not available at many of our competitors, but which gives clients maximum flexibility. We have made various enhancements to our securities lending product offering. For example, we are expanding our agency/principal services in Hong Kong, and are increasingly looking to leverage our in-house triparty capabilities to deliver a broader product suite to clients.

For agency lending, 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. Our global lending platform now enables assets in any major 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.

In terms of principal lending, we operate a single trading engine across BNP Paribas Corporate & Institutional Banking. Clients benefit from the combined capabilities of our Securities Services trading desks (i.e. equities and fixed income) as well as our Global Markets trading desks. By leveraging these channels together, BNP Paribas provides optimal pricing and utilisation to its clients, who are serviced by BNP Paribas Securities Services and benefit from its operational and reporting capabilities.

**Q: Do you have a message for new lenders contemplating entering the securities lending market in 2020?**

First, you need to assess whether a principal or agency model is the right solution. The two offerings are readily available but the risks are ultimately very different. For instance, a large asset manager might prefer to go for the agency model as it provides better risk diversification although other firms may opt for the operational simplicity that comes with the principal model.

Second, firms must identify their optimal risk-return framework (i.e. type of collateral an entity can accept, nature of the tenors). Collateral ‘flexibility’ in particular is a critical factor for beneficial owners to consider when setting up a new lending programme. Participants must also seek assurances that their service providers have excellent operational controls in place along with robust post-trade reporting.
One notable side effect of the bond 'rally' is the increase in duration, which has created significant risk as and when yields increase (take, for example, the +45bp yield move between late August and early November 2019, which caused some long-dated bonds to drop by as much as 20%). Today, risk is being shifted towards so-called risk-free assets, where potential losses will be higher due to the impact of duration and where volatility is structurally higher. This significantly reduces the Sharpe ratios of risk-free assets, rather than those of risky assets. By way of example, Bund bond prices have been much more volatile than high yield bonds.

The yield spiral is another side effect of a low/negative world. Investors are caught in the spiral – forever chasing that extra yield, driving yields lower and increasing the pool of negative-yielding bonds. This pushes many to move outside their comfort zone into alternative, but less liquid, asset classes. Assets from private markets have become a key investment alternative to public markets and the size of these market is at a formidable USD 5.8 trillion. If global growth slows in 2020, as we and many others expect, risky assets are likely to underperform and withdrawal pressures are likely to drive losses in this illiquid sector.

**The dramatic effect on pensions**

Lower rates have also had a dramatic effect on pension schemes, which are grappling...
guaranteed products where the yield is for liquidity and risk reasons). A similar problem is facing many life insurers, especially in Germany, where they have sold yield-guaranteed products where the underlying asset yield does not meet the guaranteed yield.

As yields have fallen, listed companies have been more eager to borrow money in order to reward shareholders via dividends and buy-backs. This has fuelled the rise in global stock markets, while also driving up leverage in many company balance sheets.

In fact, US BBB and Single B company leverage (net debt to EBITDA) is now at a ten-year high. On any economic slowdown, earnings will fall further, fuelling leverage and driving more rating downgrades. This is a key risk, given that the US BBB sector accounts for 57% of the IG US credit market.

Fund industry disruption
One final point to mention is the disruption to the fund industry. With listed equity asset valuations near their highs and bonds paying near zero or negative yields, we have witnessed an outflow from more expensive actively managed funds into cheap passive funds and exchange-traded funds (ETFs). In the US, equity ETFs' assets under management (AUM) are now larger than the AUM of actively managed equity funds. Given the easy accessibility to financial markets that ETFs create, many retail investors have direct access to trade assets that in the past were the domain of professional investors alone. While this may not be a problem in a bull market, it creates an asymmetry in a bear market where panic selling by ETF holders is a distinct reality, thus exacerbating volatility.

In summary, the drop in global government bond yields is a sign that risks are increasing in global markets. While central bank policy has so far averted a recession, further weakening of the economy or a rebound in yield due to an improvement in the economy is likely to push volatility higher.

Can rates rebound off these low levels? Yes they can, but we cannot see a case for yields increasing back up to 1980 levels, let alone 2000 levels, as there are enough key structural factors keeping rates down – i.e. globalisation, ageing populations and regulation.

- Globalisation, ageing populations and regulation
  - Globalisation has enabled companies to reduce their costs via outsourcing production, thereby creating downward pressure on inflation
  - People are living longer, and hence need to save more in order to better plan for expenses they get older
  - Finally, regulation and capital requirements have further increased the demand for safe assets, with banks having to hold substantially larger levels of capital and liquid reserves

"We cannot see a case for yields increasing back up to 1980 levels, let alone 2000 levels, as there are enough key structural factors keeping rates down: globalisation, ageing populations and regulation."
SFTR: THE ‘BIG BANG’ OF REPORTING REQUIREMENTS

The EU’s Securities Financing Transactions Regulation is meant to shine a light on the shadow banking sector. Haroun Boucheta, Head of Public Affairs, and Candice Mac Callum, Head of Transversal Solutions for Market and Financing Services at BNP Paribas Securities Services, explain how the regulation will affect the securities industry and what organisations need to do to prepare for its phased implementation.

The draft Securities Financing Transactions Regulation (SFTR) is based on the following three pillars:

1. Transparency to fund investors: UCITS ( Undertakings for Collective Investments in Transferable Securities) and AIF (Alternative Investment Fund) management companies must disclose the use of SFTs to investors in their regular reports and pre-contractual documents.
2. Collateral reuse: the reuse of financial instruments can only occur under a specific legal framework where the providing counterparty is duly informed about the potential risks related to reuse and has given its prior express consent.
3. Transaction reporting: counterparties must report their SFTs to a European Union-approved trade repository.

The first two pillars are already in force. A series of delegated and implementing regulations were published in March 2019, and the third pillar is going to enter into force in the coming months according to the following timetable (depending on the type of counterparty):

- 11 April 2020
  - Reporting obligation for credit institutions and investment firms as well as all third-country regulated firms
- 11 July 2020
  - Reporting obligation for central securities depositories and central clearing counterparties
- 11 October 2020
  - Reporting obligation for all other financial counterparties
- 11 January 2021
  - Reporting obligation for all non-financial counterparties

Core reporting requirements
Both counterparties to an SFT must report the details no later than the working day following the conclusion, modification or termination of that transaction. The report must include four categories of information: counterparty data; loan and collateral data – including the Unique Trade Identifier (UTI)*; margin data; and reuse data. SFTR applies to all European counterparties, whether credit institutions, investment firms, fund managers or non-financial counterparties (corporates).

The key data challenges
SFTR implies some major data challenges, not least that:
- Each SFT should be reported to a trade repository. This requires a high volume of data: around 150 fields, with 62 to be matched by the trade repositories. This data will likely be fragmented – i.e. residing in different counterparties’ systems – making capture in the right format to deadline a challenge.
- New data is required, such as information on collateral reuse (i.e. whether the collateral is available for reuse or has been reused with the corresponding proportion).
- The UTI is an entirely new field and data management process for the SFT industry and counterparties: ‘it will be essential not only for trade reporting but also for risk and reference data’.

The third pillar of the Securities Financing Transactions Regulation – transaction reporting – is due to enter into force according to the following timetable:

- 11 April 2020
  - Reporting obligation for credit institutions and investment firms as well as all third-country regulated firms
- 11 July 2020
  - Reporting obligation for central securities depositories and central clearing counterparties
- 11 October 2020
  - Reporting obligation for all other financial counterparties
- 11 January 2021
  - Reporting obligation for all non-financial counterparties

From a data perspective, SFTR will be a complex piece of regulation for firms to implement... Market participants should already be looking at their target operating model for implementation and considering the need for the right vendor solution

Haroun Boucheta
Haroun Boucheta is Head of Public Affairs for BNP Paribas Securities Services, a role he has held since September 2018. Before joining the Group, Boucheta was a director within the Regulatory Strategy Team of Société Générale Global Banking & Investor Solutions.

Candice Mac Callum
Candice Mac Callum has worked within Market and Financing Services (MFS) at BNP Paribas Securities Services since 2012. Since March 2018, she has been Head of Transversal Solutions. Prior MFS roles include Head of Regulatory Watch and Global Product Development.
How BNP Paribas can help its clients

From an early stage, BNP Paribas Securities Services has been involved in the SFTR implementation process and in the major industry working groups. We are fully committed to supporting our clients with their SFTR reporting obligations by offering two reporting options:

- Delegated reporting, where BNP Paribas Securities Services manages all steps of the reporting process on behalf of the client by using its post-trade capabilities. When counterparties delegate reporting, they retain responsibility for the management of their relationship with the regulator and for ensuring that reports submitted on their behalf are accurate.

- Assisted reporting, where BNP Paribas Securities Services leverages a modular front-to-back solution to generate ready-to-report files (matching, enrichment, normalisation) held at the client’s disposal.

BNP Paribas Securities Services is proposing these reporting solutions as part of its agency lending, exclusive lending and fail coverage programmes.

Next steps for reporting firms

Firms need to review data quality, especially with regard to those fields that can potentially cause pairing issues and breaks (e.g. price, values, Legal Entity Identifier). This also means that firms will need to identify all relevant data sources and ensure data consistency along the reporting chain.

Double-sided reporting will require counterparties to pre-reconcile a tremendous set of data within a pre-defined timeframe, throughout the entire trade lifecycle, in order to prevent rejection from trade repositories. Counterparties will need to align their interpretation of data and fields and set a series of tests to ensure the robustness of the workflow.

Managing exceptions with counterparties will be critical. Reporting firms should define workflow with a clear allocation of tasks. Strong record-keeping and audit trails should be set up in case of legal issues and to ensure continuous operational improvement.

The benefits of a vendor solution

SFTR is a necessary piece of regulation. Yet it is fair to say that, from a data perspective, SFTR will be a complex piece of regulation for firms to implement.

In light of this complexity and the tight timescale for the transaction reporting pillar of SFTR to come into force, market participants should already be looking at their target operating model for implementation and considering the need for the right vendor solution. If used, a vendor solution should have the following features:

- UTI generation, pre-matching and submission to trade repositories, and post-trade lifecycle management
- An intuitive interface between counterparties’ front-to-back systems. This is particularly helpful because data, as mentioned, will be fragmented and reside in multiple systems.
- A high level of data quality, as the reporting obligation and its related liabilities will lie with the counterparties of the SFTs.

* Sometimes referred to as the Unique Transaction Identifier
** The formula can be found in paragraph 319 of the implementing measures published in March 2017 – Technical standards under SFTR and certain amendments to EMIR
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