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BNP PARIBAS

BNP Paribas On The Cusp Of Podium As Three-Pillar Platform Takes Hold

As institutional investors have increasingly diversified their portfolios through quantitative investment solutions over the last 12 to 18 months, BNP Paribas has itself diversified its equity derivatives platform and client base. Historically recognized as a leading provider in areas such as alternative risk transactions (ART), dividend derivatives and dispersion among other flow products, BNP Paribas has increasingly tilted its platform toward QIS and delta one, has embraced digitalization, has ramped up its client coverage with senior hires across financial engineering, trading and sales and brought on board an increasing number of institutional investors globally. BNP Paribas' ***Emmanuel Dray*** *spoke to EQDerivatives'* ***Rob McGlinchey*** *on how its three-pillar approach to equity derivatives is reaping rewards for the firm and its clients globally.*

Equity derivatives is written into BNP Paribas' DNA. In recent years the firm has ranked as a leader in equity derivatives across flow and structured products globally. In an environment of capital constraints and increased pressure on banks' inventories, BNP Paribas has set itself apart in partnering with investment managers and offering innovative alternative risk transaction solutions since 2008, whether in monetization risk transaction options, corridor variance swaps or in its Athena dividend solution, among other products. It has also strengthened its foothold in index flow.
The firm has maintained its commitment to both dividends and volatility as asset classes. In Europe, for example, over the last five months BNP Paribas ranked as the number one market participant in all dividend futures and number one in options on volatility futures, according to Eurex. It is also the second most active market participant in the European index equity options market, out of which it is number one in EuroStoxx 50 options. The firm also has a 47% market share in Eurostoxx 50 total return futures that it pioneered with Eurex.

BNP Paribas' commitment to equity derivatives flow products has come despite the competitive nature of the market, the regulatory environment and the relative pullback from equity derivatives from some macro funds and other banks amid low volatility across asset classes in recent years. The latter part of 2017, for example, was marked by a lack of market conviction and lack of directional trading from hedge funds. In its place was a growth in relative-value trading, dispersion and alternative risk transactions from hedge funds and institutional investors, which carried on into 2018 prior to the February vol spike and is now again finding traction among investors as vol normalizes. The firm has also been working with an ever increasing client base in implementing systematic hedging solutions more recently following the volatility spike in February.

As 2017 became increasingly characterized by a lack of appetite among some multi-strategy and macro hedge funds for traditional flow instruments, BNP Paribas began implementing its three-pillar approach to equity derivatives. This move was further driven amid a growing trend of institutional investors accessing new and diversifying sources of returns, such as alternative risk premia, and its peers investing in machine learning and automation.

Dispersion in particular has found traction among a wide and diversified range of investors over the last year, with BNP Paribas lauded by clients in expanding its offering of packaged and geometric dispersion through a multitude of instruments, from swaps and certificates to vanilla options and more exotic implementations. This is one asset class that shows BNP Paribas' three-pillar approach to equity derivatives is already coming to fruition.

The 1st Pillar - Clients

Under Emmanuel Dray, global head of EQD institutional sales, the first pillar is already driving increased revenue at the firm and Dray has overseen a diversification in its institutional client base.

In 2015, more than half of BNP Paribas' top 10 clients in equity derivatives were hedge funds and currently that figure stands below 20%. "It is not that we are no longer focused on servicing our hedge fund clients, but we observed that we needed to diversify our client base. The strategy around clients was to diversify and to better penetrate other segments of the market, including traditional asset managers, global pension funds,

sovereign wealth funds and grow our insurer base where we are already making traction," said Dray. "This strategy around clients is already in motion and starting to deliver great results. For example, a leading European asset manager has recently awarded BNP Paribas with a landmark cross-asset alternative risk premia mandate following a highly competitive tender process and intense due diligence."

The 2nd Pillar – Products

Dray notes that although the firm has diversified away gradually from focusing largely on index flow, it is still committed to the business. "We have been, are and will continue to be very strong on index flow, whether that is the EuroStoxx 50, the Nikkei 225 or the S&P 500, but this is becoming a very competitive market. You are now quoting sometimes choice prices where clients are expecting you to deliver a multi-million vega trade with that kind of margin. It's a franchise product, where we are happy to commit capital to those clients but we want to service our ever-increasing global client base across multiple solutions."

To service its client base, BNP Paribas has set up an advisory board and expanded its team as it focuses on delivering innovative solutions across equity financing and delta one, alternative risk transactions, quantitative investment strategies (QIS), and sustainable investments. QIS is split between option-based strategies, like systematic hedging, cross-asset alternative risk premia, equity factor and thematic indices.

The advisory board is in motion across different product areas and markets as the firm integrates its new hires across structuring, sales and quantitative strategy. Among those hires are Julien Turc, a cross-asset quantitative strategist and pioneer in machine learning, who joined BNP Paribas as head of the QIS Lab and Emmanuel Benchimol from Société Générale, as head of delta one solutions.Solenn Le Floch joined last year from Credit Suisse as a senior risk premia advisor in London while Tomoyuki Mori and Lachlan Evans joined from JP Morgan respectively as head of cross asset solutions sales in Japan and cross asset solutions sales in Australia and Yajur Arora joined from Deutsche Bank as QIS Specialist for Asia Pacific. Other high profile financial engineers, sales and traders are set to join the firm globally over the next few weeks.

"The advisory board along with our new hires shows the huge ambition behind equity derivatives at BNP Paribas. When we look

at market research on where we stand against our competitors, those ahead of us are defined by these sizeable U.S. client trades or the larger QIS solutions. We therefore need to accelerate our development plan," said Dray. "The U.S. market, for example, is a massive market – around 80% of assets under management of hedge funds are based there and nine of the top 10 global asset managers. We are already addressing that – for example we hired Nathalie Texier-Guillot late last year as head of equity sales, Americas. She has a fantastic track record in developing equity derivatives solutions for institutional clients, strengthening franchises and adding value. We will continue to bolster our U.S. franchise as we find increased traction from hedge fund and institutional clients, as we will in other geographical areas where client demand exists."

Within QIS, one product area where BNP Paribas is increasingly finding traction is in alternative risk premia with institutional investors. The firm already works closely with asset managers and mutual funds on new alternative risk premia solutions or where those strategies are embedded in those funds, with the focus on supplementing that with increased coverage across institutional investors. For example, over the last year, the firm partnered with a leading U.S. asset manager to develop a risk premia index and a liquid alternative fund that provides exposure to the index, which itself allocates between seven different strategies developed by BNP Paribas' QIS group. BNP Paribas also works closely with Research Affiliates, most recently launching a new RAFI ESG strategy.

For Dray, BNP Paribas will approach alternative risk premia by leveraging the firm's unified platform across markets and by continuing to invest in its execution framework. "In terms of global markets, we have a unique position compared to other sellside firms by having a unified platform. It's not like some other firms where you have fixed income on one side and equity on the other side. EQD has a cross-asset mandate at BNP Paribas as far as risk premia is concerned."

The 3rd Pillar - Process

Dray also feels that BNP Paribas can differentiate itself from its peers in alternative risk premia through its execution offering. Some asset managers and many institutional investors are no longer looking for intellectual property from sellside firms when it comes to alternative risk premia, but still require sellside firms for execution. Dray feels there is still a case for a combined offering in alternative risk premia when it comes to IP and execution.

BNP Paribas' execution framework is already fully fledged on the flow side, providing best price execution and liquidity across multiple markets, asset classes and time zones. At present, BNP Paribas' very low latency execution framework supports its market making activities, but Dray foresees this serving as an execution platform for alternative risk premia.

"In execution, who is better placed than a bank which has 15% market share on dividends, 10% on market share on EuroSTOXX 50 index options, a leading position in cash equities turnover, and which has continued to invest in high frequency, latency, and so on?" said Dray. "We have recently won two big mandates with one Australian pension fund and one European asset manager. Those managers have their own risk premia strategies, and asked to leverage off of our execution infrastructure."

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>
> **–Emmanuel Dray, BNP Paribas**

Surrounding the third pillar – process – execution is only one part of the firm's so-called investment journey through BNP Paribas' sales function. The firm has been developing its SmartDerivatives internal tools so that its sales teams can analyze and monetize data, such as detecting client and flow patterns. SmartDerivatives is already fully deployed on delta one and will be rolled out across flow products shortly. BNP Paribas also plans to expand its team in machine learning and AI as it seeks to further automate its sales process.

"If each time the Nikkei 225 drops by 1.5% usually you receive a fast money trade, i.e. a client calls to buy some upside call, then the day it goes down by 1.5% and you don't receive a call it gives you good information," said Dray. "So the idea is to detect patterns between clients' requests and market patterns. It's a gift to the sales people providing a new opportunity to engage with clients. To say okay, when the market usually does this, you do that. So they have that at the back of their mind, but we want to automate that process."

Connecting The Dots

When judging BNP Paribas' position in quantitative investment strategies, specifically alternative risk premia, Dray feels that BNP Paribas has been successful in servicing asset manager clients, yet neglected the institutional community when expanding initially into QIS. He notes that the firm has addressed that, reflected in

the diversification of its current client base globally and BNP Paribas' commitment in supporting the equity derivative business' expansion in to areas where it sees value, for example delta one and sustainable investments, while leveraging the strength of its flow and ART offering.

"It's something we are now correcting heavily, because for me, the link between ART and risk premia is relevant. For me, ART is to harvest risk premium in a discretionary manner where ARP is to harvest risk premia in systematic manner. The terms which of vol, correlation, dividend, etc, those market imbalances show there is some risk premia. Even if you are calling them discretionary, which is the approach of some Canadian institutional investors, you on the other side have those that approach it in a systematic manner and that is the case for Nordic pension funds. Historically we have not been as strong in the Nordics and that's why we missed a bit of activity – this is another area of clients that has been addressed," said Dray.

He added that he feels BNP Paribas is in a unique position in equity derivatives compared to its competitors as it continues to grow its commitment to the market by positioning itself for the long haul. "I think we have a unique position that we will capitalize on. We have a Global Markets and CIB management commitment behind equity derivatives, a lot of those managers have come from the equity derivatives business. Today one of our leading positions is in equity derivatives so it means that we are here to last. When I talk to clients, I say trade a 10-year equity swap with us because you can be sure that we're still going to be here in 10 years to unwind it," said Dray. "So, management commitment, stability, credit rating on the swap business - it's important to have a decent credit rating - execution capabilities as I mentioned, quant DNA, academic links, etc. Last year was our best performing year ever for QIS. So it already shows that we have all the ingredients, we just need to connect the dots and we are through these three pillars which is benefiting us and our clients." ■