House of the year

BNP Paribas


Kara Lemont Sportelli

BNP Paribas was prepared for the worst and came out the best. From persistent thought leadership on how to deal with new regulation to new strategies, products and technology platforms, the French bank has captured the mood and excelled. "BNP Paribas has become a big innovation machine and is occupying the entire space of innovation in structured products," says Jean-Eric Pacini, head of equity derivatives sales at BNP Paribas in London.

Kara Lemont Sportelli, head of fixed-income structuring at BNP Paribas in London adds: "BNP Paribas is always tweaking things; it's nothing monumental. The success is bringing the business together."

"Over the past few years, we have analysed the structured products that are not worth running the risk on for us, the end investor or the hedger," says Pacini. "There are still a lot of people active in the worst-of market, which is painful for the end investor… The bank said it did not like variance swaps, so it pulled out. Some people disagreed. I think they agree now." Pacini is particularly proud of the long-term risk the bank has taken in central and eastern Europe, especially in Poland, where BNP Paribas is doing a 15-year deal in Polish zloty.

Shaun Wainstein, head of the equity and derivatives London platform adds: "On the macro level, we are taking less risk – such as with worst-of options – when we don't like the risk; in 2005 and 2006, we were like that on cliquets… We are more controlled these days in our capital allocated to risk… We have done big trades on the flow side, which requires quite a bit of risk, especially with UK investors over the past 12 months."

Fixed-income products were prepared for sale in Belgium, where the regulator has proved particularly vocal. Running up against competition from guaranteed returns from simple savings products and certificates of deposit, BNP Paribas stood out as the only bank to provide products based on fixed income, with the classic structured products attraction of returns when rates are up and also when they are down.

On offer was the Euribor Dual Floater Note 2014, which guarantees a minimum 1% annual coupon even if interest rates fall below 1%, resulting in the Best in Benelux Award. Fully capital guaranteed, the three-year note pays a quarterly coupon, which is a minimum of 1% and up to 4% annually. Designed for a private banking audience looking for a neutral or conservative investment, which fell into line with new restrictive rules implemented during the Financial Services and Markets Authority's moratorium, clients praised the innovative and high-quality service, from its structuring to its launch.

In anticipation of Solvency II regulations, BNP Paribas equipped a Belgian insurer with a hedge of the duration gap between assets and liabilities, while providing an attractive yield. The strategy capitalised on the steepness of interest rate and asset swap curves by buying a zero-coupon government security – Obligations linéaires ordinaires (OLOs) – stripped from a conventional bond on a forward basis at an agreed price. This suited the insurer, which was confronting a reinvestment risk in its life portfolio, and the need for a guaranteed minimum return. Buying OLO strips on a forward basis reduced the investment risk and locked in a yield that benefited from steep swap and asset swap curves.

Strength and innovation was also on show with offerings that allowed choice across different asset classes and different geographical regions and themes. In response to these needs, BNP Paribas's structuring teams created MyIndex, which enables clients to create their own tailor-made indexes. Between €100 million and €150 million notional has been put against the indexes since December 2010, according to Pacini. "We can do things like this because [our indexing business] has reached an industrial size."

Again, private banks were the beneficiaries of newly created indexes by means of Balanced Emerging Markets Notes 2017. BNP Paribas has long been bullish on the emerging markets, and it was this commitment aligned with its innovation that led to the creation of an emerging markets index covering equity and sovereign debt markets.

The index comprises 10 emerging markets funds, five invested in emerging markets equities and five in emerging markets local sovereign debt. With the underlyings denominated in US dollars, there was also a euro hedge. The final sheen came in the form of calculation by an independent agent that emphasised full transparency. The six-and-a-half year notes were 100% capital protected and offered a payoff of 115% of the final performance of the underlying index. Three public offerings of the notes raised €70 million.

The index creation included MyIndex, which enhanced transparency, simplicity and flexibility. Created in the Benelux region, MyIndex is due to be exported to other European local markets, particularly to France.

Examples of innovation included GuardInvest, which also brought transparency and simplicity. The Theam Harewood GuardInvest Euro Equity offered sustainable long-term equity investments with lower risk. In this case, call options triggered by market conditions provided partial exposure to equities. Funds under management of €9.34 million by September 5 this year came from an open-ended investment with a recommended three-year term. Retail and professional investors benefited from a quarterly protection of more than 90% of the fund's value at the previous year's recorded level.

This guarantee on maximum loss cuts Solvency II capital requirements to 10% for GuardInvest against 39% for a direct Euro Stoxx 50 investment.

There was also €67.21 million invested in the Theam Harewood Euro Long Dividends Funds by professional investors. Spying the relationship between dividends and inflation – that finds companies traditionally paying them in line with inflation – and given that dividends are negatively correlated with bonds, the bank's fund recorded an annualised return of 18.98% by August 31, 2011, against the 1.92% on offer from a more volatile investment in the Euro Stoxx 50.

The fund systematically invests in dividend swaps of differing maturities on the European benchmark; the swaps are renewed on their respective maturities. There is an override that reduces exposure to the swaps in exceptional circumstances. BNP Paribas has analysed the situation where 2012 implied dividends are being priced at a discount to their 2011 levels, with even greater discounts priced in for 2013 and 2014.

Ucits III compliance means counterparty risk is limited to 10%, while a full loss is only possible if all Euro Stoxx 50 companies fail to offer dividends for five consecutive years.

Continued desire for commodities was met with BNP's Oscillator index. The momentum-based allocation strategy was combined with value, applying two favoured equity-investment concepts to commodities.


Jean-Eric Pacini

The oscillator index provides access to 19 different Diapason Commodities Index mono-indexes and takes advantage of the low-correlation shows in commodities. Sixteen of the indexes are enhanced. The indexes optimise roll yield by dynamically accounting for the shape of the forward curve of the underlying commodity and selecting the optimum contracts on which the index rolls each month.

The intent is to create a better roll return that is decorrelated from spot returns. The indexes use an optimal roll algorithm that aims to select the optimum futures contracts on which to roll, minimising the roll cost of contango commodity markets and maximising roll return in backwardated commodity markets. The relative performance of the mono-indexes is compared to the whole, equally weighted basket. A BNP Paribas algorithm allocates a weight for each commodity, with a maximum of 20% designed to limit concentration. There is a 35% limit on petroleum mono-indexes to allow the index to be tracked by Ucits III-compliant funds.

The annual volatility target is set at 11%: leverage can be 125% when the volatility of the core strategy is below 11%; the exposure to the commodities is reduced when volatility is above 11%.

BNP Paribas has long offered answers to volatility in equity, and has distinguished itself by doing the same in fixed income, adding further fuel to those that have labelled volatility as an asset class. The capacity to offer volatility in all forms, particularly as fixed-income indexes, puts the bank at the forefront of creativity in this field. This has resulted in it receiving the Interest Rates award.

Vol Edge, its pioneer volatility strategy, has delivered systematic protection throughout the financial crisis, and has been adapted to suit the changing financial world. Rather than relying on a systematic roll of futures and falling prey to contango, BNP Paribas created Vol Edge Spread to deliver implied volatility and benefits from steep contango.

"The problem is so many people took volatility as a hedging vehicle over time that the price of volatility has gone up, and everybody has suffered losses of 20%, 30%, 40% on the cost of carry," says Pacini. "When volatility spiked, people sold quickly, preventing volatility from going up on a mark-to-market basis."

The bank's expertise in implied volatility combined with its skills in structured products has allowed it to mix its core long forward variance position with a short forward volatility position. The resulting product is net long volatility and convexity, which protects investors from tail events. The use of variance is a hedge against downside risks and optimises investment and tail-risk protection.

The bank has also been a pioneer in providing retail products that generate long-term savings, with its Regular Premium range.

Education has continued through the BNP Paribas Academy's teaching on volatility, dividends and hedging in London, Paris, Brussels, Hong Kong, New York and Tokyo. Specific project managers are designated for each product campaign.

The collaboration that exists between the structuring, trading, marketing and sales teams is further fostered by close links that stop short of a cross asset class platform. "We have dramatically increased our collaboration this year," says Pacini.

The most obvious statement of unity is in the common team for products issued on the SecurAsset (collateralised issuance vehicle) platform. Next, the bank is aiming to produce a common platform in the index business. "We have shown consistency across all asset classes," says Lemont Sportelli. "We studied ways of working together and decided to do that on wrapping, where we now have a joint team reporting to Jean-Eric Pacini and me… More co-operation is encouraged when a fixed-income product is being sold to retail."

A dedicated intranet site for the Belgium and Luxembourg sales force of Belgian bank Argenta included a training programme with online sales training and customised videos, brochures for all products, adviser teasers, online questionnaires and flash animation reminders.

There was also a tailored marketing campaign for a life insurance product for Mutuelles du Mans Assurances (MMA), which included 75,000 copies of a brochure explaining the fundamental mechanism of MMA SerenActive 2, and helped raise €30 million for the French insurance company.

Secondary trading is available through eTrader, an electronic cross-asset trading and quotation platform.

Improvements in transparency have also come from a new generation of constant proportion portfolio insurance and time invariant portfolio protection structures that benefit from the bank's look-through approach, which enables a comprehensive analysis of gap risk usually produced when defining the worst-case portfolio. Every asset in a portfolio is analysed, allowing asset managers to allocate risk while managing gap risk at the individual holding level.

BNP Paribas has so far introduced the approach in the US with Janus Protected Series and has plans to do the same in Germany, Italy and the UK.