CREDIT DERIVATIVES HOUSE OF THE YEAR

BNP Paribas

Strong structuring capabilities, consistent growth in the bank's credit options and exotics business, penetration into new markets and products, along with market participants commending the bank for vastly improving its service across cash bonds and credit derivatives are all achievements helping to crown BNP Paribas as the best credit derivatives house in Asia during the past year.

"We have substantially increased the breadth of our product offering and gone deeper into the region to cover new markets," says Cedric Podevin, head of fixed income structuring for Asia in Hong Kong. "Risk management makes our integrated platform much stronger and increases our ability to develop more structures. We work closely with the quantitative and trading teams on the design and execution of products to ensure there is value for clients as well as the bank."

Atul Sancheti, co-head of credit structuring for Asia-Pacific in Hong Kong, adds that given low interest rates in most developed markets, lightly structured products have proven popular among clients to provide yield enhancement, while requests for liquidity management solutions have risen during the award period. Also, there has been a greater interest in local markets, as domestic economies grow and investors seek to gain exposure to the continuing economic growth in Asia.

The French dealer's credit exotic and options volumes increased by around 150%, while funded exotic credit structures rose almost fourfold in 2010/11, compared with 2009/10. This excludes the $1 billion alternative funding business, which provides financial institutions with liquidity management services and has been developed as a new activity altogether. BNP Paribas estimates overall volumes of credit exotic and options stand at $3 billion-plus for Asia ex-Japan – excluding volumes from vanilla flow credit in bonds and CDS.

We have added around 25–30 new clients in credit exotics and options
Atul Sancheti, BNP Paribas

"Broadly, we have added around 25–30 new client relationships in the credit exotics and options space across Asia," says Sancheti. "This has been done mainly in Hong Kong, Korea and the southeast Asian countries of Singapore, Malaysia, Indonesia and Vietnam."

The bank has also invested in the development of onshore credit derivatives markets in various domestic markets, such as China and India. BNP Paribas executed what is believed to be the first onshore trade of around 50 million renminbi with a Chinese financial institution in the last quarter of 2010. "We are keenly involved in the market's development including discussion with regulators for the overall framework, and helping shape methodologies and documentation," says Sancheti. "We will be contributing to onshore credit derivatives market development in various domestic markets in Asia."

A light touch

Lightly structured products, meanwhile, proved a hit with Japanese clients, particularly credit-linked notes (CLNs) and repackaged transactions in the first half of the year. The majority of demand originated from financial institutions as well as life insurance companies, corporates and offshore hedge funds. Volumes since January have increased 80–100% from 2009/10. "It has been a very good year and we saw strong demand from clients, some of whom have returned to the credit market. Interest has focused on lightly structured products that are simple and quick to execute because the markets have been very volatile," says Mineng Jiang, who works in fixed income sales for the Japan credit structuring group in Tokyo.

The weaker market conditions and widening spreads witnessed after the Great East Japan Earthquake in March prompted some clients to invest in high quality, well-rated domestic credits with sound fundamentals. Given the low demand for corporate loans and increased deposit amounts for domestic financial institutions, investors have much more incentive to deploy their cash for investment, adds Jiang.

Demand from private banks, financial institutions and corporates in Asia ex-Japan has also centred on lightly structured transactions, with strong interest in CLNs, first-to-default packages, index basis-linked notes and credit hybrid transactions.

Multiple clients have interest in and have executed credit index basis-linked notes exposed to the Markit CDX Emerging Markets and Markit iTraxx Europe Subordinated Financials indexes. These notes allow investors to capture the arbitrage between movements in the overall index and its constituent single names, and can reference or be substituted by any investment-grade or high-yield index in Asia, Europe and the US.

BNP Paribas has also seen interest in Singapore dollar, Taiwan dollar and won-denominated credit instruments from private banks, insurers and other financial institutions. "The note guarantees principal and coupon, offers returns around 130bp over swaps and also provides the client with no gap risk, no default risk and no basis risk," Sancheti says.

Cedric Podevin, BNP Paribas

Volumes of CLNs and first-to-default notes increased almost fivefold year-on-year. First-to-default notes allow clients to take a bullish view on a basket of credits and have attracted interest from private banks and institutional investors in Singapore and Hong Kong. Reference entities tend to be strong Asian credits and sovereigns, and demand has been greatest for three-year tenors.

"There are a number of good names that are trading fairly wide and the notes are popular with clients that have strong credit views of companies that have good fundamentals and stable ratings over the next three to five years," Sancheti says. "Having a diversified basket from Korea and Malaysia combined with a strong Asian credit like the Republic of China or Hutchison Whampoa, would provide a really good pick-up and a coupon of between 5% and 6%."

High times for hybrids

Large volumes of credit hybrid products during the past year have been placed with insurance companies, pension funds and private banks in regions such as Singapore, Hong Kong and South Korea. The most popular structures were range accrual-type transactions linked to views on future interest rates. The coupon is typically an annual fixed rate that is paid when the interest rate lies within a pre-defined range. Given interest rates are low in the US and Europe and that sole range accrual products can only offer limited yield, products were given a 'kicker' by the inclusion of credit exposure to a high quality reference entity, such as the Republic of Korea.

Desmond How, Nomura International

BNP Paribas also helped financial institutions in the region effectively manage their cash and liquidity needs by providing liquidity management services. Repos and structured reverse repos have allowed clients to exchange collateral, such as corporate, financial and sovereign bonds or asset-backed securities for a better yield and liquidity premium.

These have been single transactions in the region of $200–300 million conducted with banks and insurers in Hong Kong and Singapore. "The structure is similar to a collateralised loan and benefits the client as accounting is usually accrual treatment with no mark-to-market and there is a higher expected recovery than senior unsecured credit exposures," says Sancheti.

BNP Paribas has also championed liquidity in local markets by giving offshore investors exposure to domestic Asian bonds. By structuring local market access products, foreign clients do not need to have qualified foreign investor status or go through the trouble of setting up a local custodian.

Interest has come from private banks and financial institutions from Singapore, Hong Kong, Indonesia and South Korea looking for short-dated paper from three, six months and up to one year in underlyings that include domestic Malaysian, Indonesian and Korean debt. Sancheti adds that single notionals are fairly small as a private bank investor would typically take an exposure of around $2 million but total volumes stand at between $50 million and $75 million.

"Overall, trades have and can be done on government debt, corporate bonds and commercial paper across a wide variety of markets including various Asian and non-Asian jurisdictions," says Sancheti. "We have seen global flows with non-Asian investors looking to take exposure to Asian underlyings as well as the reverse."

Clients stress the importance of BNP Paribas as a reliable counterparty when describing why it is a leading credit derivatives house. One head of credit trading at a Singapore-based asset manager says that although he only trades infrequently with BNP Paribas, the bank has been one of the better credit houses particularly in CDS, along with Credit Suisse, JP Morgan and Nomura. The trader says market-making in CDS by some top-tier banks has deteriorated during the awards period. "Some banks do not feel like a liquidity provider or a franchise promoting Asia credit," he says. "It has been hard to find a reliable counterparty as the pricing is proprietary in nature."

Desmond How, head of global capital management at Nomura International in Hong Kong, views BNP Paribas as a top-tier counterparty that is particularly strong in European financials, CDS indexes and Asian high-yield, high-grade and sovereign markets. "Our credit strategy has a focus on liquidity, which has been a scarce commodity in volatile markets," How says. "BNP Paribas has stepped up and provided very good liquidity for secondary market bonds during normal markets and more importantly in panicky times."