QUINTESSENCE

Smart thinking in finance

Issue 3 | 2022

SECURITIES SERVICES INDUSTRY TRENDS 2022

BNP PARIBAS

Quintessence

Dear Client,

As 2022 kicks off, we look at the themes that are likely to matter to your business this year:

- **Economics:** Markets 360, BNP Paribas Global Markets' strategy and economics division, examines the global outlook for 2022
- **Digital assets:** Blockchain and digital assets can create new market opportunities for investors seeking diversification and for issuers looking for new funding
- **Sustainability:** How sound data and analytics can help boost ESG's credibility
- **Private capital:** Sustained inflows into private capital are placing growing pressure on the operational infrastructure. We look at potential solutions
- **Clearing in APAC:** The rise and rise of third-party clearing

I hope you find this special edition of Quintessence an interesting read.

My team and I look forward to discussing your priorities for this year and beyond.

Alvaro Camunas
Global Head of Client Development, Securities Services, BNP Paribas

BNP PARIBAS

BNP Paribas Securities Services
Corporate and Institutional Banking
7 Harewood Avenue
London NW1 6AA

cib.bnpparibas

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Lemonbox
Kemp House, 152-160 City Road,
London, EC1V 2NX

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GLOBAL OUTLOOK 2022

BULLISH – SELECTIVELY

Central banks in the Southeast Asia region have no rush to hike interest rates anytime soon and low interest rates should help with the recovery into next year.

Marcelo Carvalho, Head of Global Emerging Markets Research, BNP Paribas Markets 360

GLOBAL OUTLOOK

While many see a risk of stagflation, Markets 360 analysts expect global growth – China being a notable exception – to exceed both consensus and its trend rate in 2022 and 2023, and are selectively bullish on financial markets. The emergence of the omicron variant is likely to affect the short term-path of activity and inflation but doesn't substantially alter our positive view of the medium-term outlook for the global economy.

Developed & emerging markets

- Developed markets: although Markets 360 experts think headline inflation will slow; they expect underlying price pressures to keep building, paving the way for monetary policy normalisation. According to their forecast, monetary and financial conditions in 2022 will be less accommodative, with an above-trend path for GDP growth.
- Emerging markets: with central banks under pressure to raise interest rates to fight inflation, the Markets 360 team foresees slower growth here, with exceptions. Latin America faces a risk of stagflation due to political volatility, tighter policy and structural issues, while emerging Asia is set to outperform, given a reduced need to tighten policy.

G10 rates

Markets 360 experts expect volatility to remain high in 2022 due to the uncertainty of central bank policy normalisation. In their view, the US Federal Reserve will first hike rates in June 2022 and start quantitative tightening in 2023, while the European Central Bank is likely to maintain favourable financing conditions for longer and slow its purchases next year.

Equities

Markets 360 strategists expect bullish equity markets in 2022, particularly in H1, as long as real yields remain in negative territory.

- NKY (Nikkei 225 index) is likely to outperform due to its relatively low valuations
- SPX (S&P 500 index) should rise as an increase in US corporate tax now seems unlikely
- SX5E (Euro STOXX 50 index) could move higher as experts expect a rise in consensus earnings expectations
- MSCI EM is likely to underperform developed markets, but still deliver positive returns

Credit

Despite its overall bullish view on markets, the Credit 360 team is bearish on credit in 2022 due to quantitative easing tapering that suggests outflows at a time when issuance continues to be robust. Strategists favour loans and high yield over investment grade, but remain cautious on emerging market rates and FX.

Commodities

The Markets 360 commodity desk strategy team has a bearish outlook overall on silver, copper, nickel and aluminium, expecting a short-term rise in the Brent oil price followed by a decline in 2022. While they expect base-metal prices will recover in the second half of the year, they remain bearish on gold.

ESG

After the long-awaited COP26, the focus on sustainability and ESG is likely to increase in 2022, reflected in bond market issuance that the Markets 360 team expects to rise by 60%. Key areas of change are likely to be:

- Investment in renewable energy,
- Electric vehicles,
- Industry transitioning.

The Markets 360 team is confident these will result in an increase in green bond issuance from NextGenerationEU, corporates and emerging markets, with regulation helping drive strong flows into ESG-themed equities, especially in Europe. ✥

PODCAST
BNP Paribas | Global Markets
Global Outlook 2022 — Bullish Selectively

DIGITAL ASSETS HAVE A bright future

Blockchain and digital assets can create new market opportunities for investors seeking diversification and for issuers looking for new funding. From 2023, a new European regulatory framework should be in place to support a continental market for digital assets.

Daniel Turquety, Deputy Head of CIB Digital, BNP Paribas

Few European debt issuers, whether sovereign or private, currently issue and exchange digital assets using blockchain. Yet blockchain technology represents a major potential step towards decreased transaction timeframes, streamlined contracts and reduced transaction costs. Furthermore, digital assets can offer increased liquidity to investors through a secondary market. Investors will not only benefit from reduced settlement times, but also automated KYC.

Today, an investor looking to access the market for bank loans can only do so through a bank capable of issuing securities. As digital assets are underpinned by blockchain technology, it is technically possible to create a digital transferable contract from a bank loan. If the relationship between client and financial institution remains the same, the use of digital assets allows European issuers to diversify their sources of finance by allowing more participants into the secondary market, providing that they meet specific criteria. For investors seeking asset diversification, blockchain can open access to new types of assets that currently are either inaccessible or too costly.

> Despite a lack of regulatory harmonisation, the potential for growth of a European market for digital assets means the stakes are high.

An integrated banking model to support issuers throughout the value chain

Within this framework, banks can support clients wanting to issue digital assets from origination to distribution into capital markets. The BNP Paribas integrated model supports clients right across the value chain: structuring digital assets, primary placement, issuance, secondary markets, custody of digital assets.

Despite a lack of regulatory harmonisation, the potential for growth of a European market for digital assets means the stakes are high. However, digital assets are currently regulated at a national level. Therefore, aligning responsibilities across different jurisdictions in order to better protect investors and issuers is critical. This is the aim of the Digital Finance Package – a European Commission project envisaged for 2023. If this legislative process succeeds, it will create a new legal framework for Europe. For non-financial digital assets, the proposed MiCA (Markets in Crypto Assets) regulation aims to harmonise national legislation to create stronger legal recourse for European investors buying and selling digital assets using blockchain, while also encouraging innovation. It all boils down to creating a framework to give investors and issuers confidence and thereby support the development of a single European market for digital assets.

Daniel Turquety, Deputy Head of CIB Digital, BNP Paribas

THE INDUSTRIALISATION OF PRIVATE CAPITAL

Sustained inflows into private capital are placing growing pressure on operational infrastructure that is struggling to keep pace with investor appetite.

Karine Litou, Global Deputy Head of Private Capital, BNP Paribas Securities Services

In the context of low interest rates and an uncertain economic outlook, institutional investors have continued to flock to private assets in the search for long-term performance and diversification. Private capital assets – a category which includes private equity, infrastructure, real estate and private debt funds – now account for more than 10% of investors' portfolios, up from a modest 2-3% just a few years ago.

This rapid growth shows little signs of abating. In 2021, global private capital assets under management surpassed \$8 trillion, and are predicted to reach \$13 trillion by 2025, according to Morgan Stanley. Global dry powder also reached new heights, surpassing \$3 trillion, with private equity accounting for around 68% of the total.

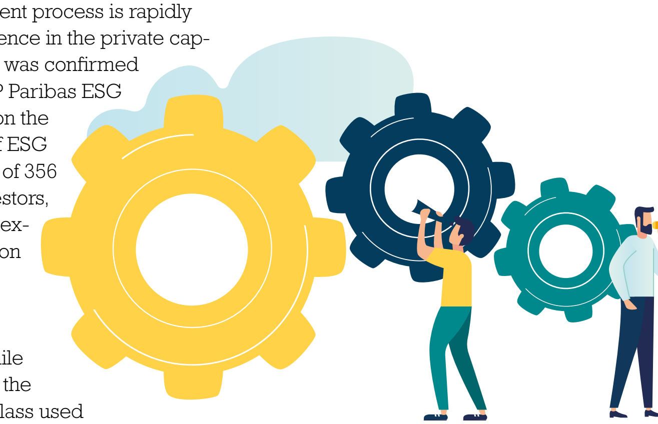
The other side of the coin

While rampant growth in the segment has presented a significant opportunity for fund managers, it has also highlighted the shortcomings of traditional operating models used to manage non-listed assets. In-house fund monitoring processes that have historically relied on physical paper and spreadsheets are struggling to keep pace with the scale and reporting demands being placed on them by sharp increases in allocation. This was reinforced during the pandemic, with in-sourced operating models facing scalability challenges during times of heightened disruption. In addition, private capital assets suffer from a lack of standardisation in the reporting and accessible data required to perform the detailed and transparent analysis that investors are accustomed to receiving with listed assets.

Supporting future growth

To truly capitalise on the rapid growth of the segment, fund managers will need operating models that can handle complexity at scale – via automation and industrialised reporting capabilities – and expand quickly into new markets without taking resources away from the front office. For this reason, outsourcing is becoming increasingly attractive. The unique challenges presented by the asset class are leaving managers with little choice but to seek out platforms that can meet their current and projected growth in private investments.

At BNP Paribas Securities Services, we are at the forefront of this transition. We continue to assist leading private capital investors with the management of their unlisted assets, including the day-to-day management of cash flows, capital calls, fund distributions, monitoring of investment portfolios and performance calculations. Our integrated end-to-end offering, coupled with a best-of-breed approach to technology and systems, aims to maximise efficiency, enabling our clients to focus on their core business activities.



Gaining the digital edge

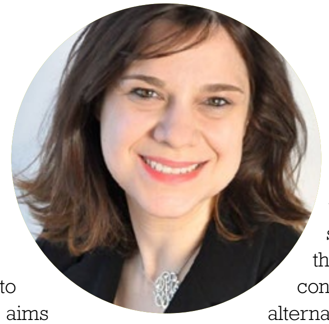
As the sector matures, another major evolution is the growing digitalisation of reporting tools for both management companies and investors. In addition to customised reporting capabilities – as well as document management and workflow functionality to streamline the operating model and digital user experience – quantitative analysis and tools to support decision-making are becoming a must-have.

To meet this need, BNP Paribas Securities Services has acquired a stake in leading private capital fintech, AssetMetrix, to further digitalise our private capital offering. The partnership will enable us to fast track the development of best-in-class solutions for non-listed investments, giving clients access to fully digital reporting and analytics capabilities as part of a uniquely integrated service offering.

Integrating ESG considerations

Along with the wider funds management industry, the integration of ESG into the investment process is rapidly gaining prominence in the private capital sphere. This was confirmed in the latest BNP Paribas ESG Global Survey on the incorporation of ESG among a group of 356 institutional investors, representing in excess of \$11 trillion in assets under management.

The research showed that, while equities remain the primary asset class used to deploy ESG considerations (60%), there is a growing ESG consciousness within alternative asset classes, particularly private capital. In fact, 41% of investors incorporate ESG considerations within infrastructure, followed by private equity/debt (38%) and real estate (37%), with asset owners leading the charge compared to asset managers.



Karine Litou, Global Deputy Head of Private Capital, BNP Paribas Securities Services

Despite facing the aforementioned challenges with standardised measurement and reporting relative to listed assets, non-listed assets have considerable potential for ESG impact. For instance, a majority private equity shareholder has the ability to influence change within a company and impose reporting around certain ESG criteria.

Indeed, the role that financial institutions have to play in helping investors move capital towards investments that deliver positive ESG outcomes cannot be understated. The new direction of travel is clear. Spurred on by mounting investor and regulatory pressure, and stark warnings from the IPCC on how urgent the fight against climate change has become, the issue will only grow in its importance in the months to come.

HOW SOUND DATA AND ANALYTICS CAN HELP BOOST

ESG'S CREDIBILITY

Investor appetite for ESG solutions is growing, and ESG products are more numerous each day. But investors are still looking for sound data and analytical tools to verify corporate and sovereign ESG claims. By Patrice Hiddinga, Chief Executive Officer, Manaos

This generates debates and questions around sustainable investing. What counts as valid ESG data? How can ESG claims be assessed across asset classes and business types? What is the true picture of ESG business impacts right through extended supply chains? In the absence of data that is verifiable, consistent and comparable, investors need access to tools and platforms that enable them to easily access relevant data from multiple sources and integrate this into their decision-making processes.

And that means that for many investors and the institutions that serve them the data challenge comes down to a simple question: whether to build ESG analytic capacity, or buy it? The self-build option can be attractive in terms of maintaining ownership of insights and supporting data, but it calls for extensive human and data resources that might be better directed elsewhere. The buy-in option is likely to be simpler, but it is costly and it generates counterparty risk.

The 'buy or build' question is a classic corporate dilemma – but we believe it may be the wrong question here. Most if not all of the data that investors need is accessible: what is lacking is integration and analytic power. There is a strong case for investors to move to a platform solution, such as ours which unifies multiple ESG data sources on a mix-and-match model, that will preserve the upside of both 'build' and 'buy' but eliminate the downsides of cost and risk.

The mindset has changed

We know from the BNP Paribas ESG Global Survey 2021 that there is a strong need for a richer and broader ESG data solution. This latest iteration of our survey shows that for banks, investors and financial traders, ESG has moved firmly into the mainstream, and the need for data that is credible, detailed and transparent is widely recognised.

For example, in our 2019 survey, not a single respondent expected that 75 per cent or more of any portfolio would incorporate ESG by 2021. Yet in this year's survey, 22 per cent of investors said their portfolios are now at this level, with 34 per cent expecting portfolios to be more than 75 per cent integrated by 2023.

This upward trend is supported by external data: by late 2021 the Net Zero Asset Managers Initiative, which supports a goal of net zero by 2050 or sooner, had attracted 220 signatories accounting for more than USD 57 trillion of assets under management . That is more than half the global managed asset pool.

Our survey also highlighted that there is much still to be done. A significant portion of respondents still incorporate ESG into less than half of their portfolio, and common challenges around data continue to impede wider integration.

The market has changed

Despite this mainstreaming of ESG, there remains little in the way of standardised frameworks that allow investors to make robust comparisons of ESG performance across assets, industries and geographies. Many critical disclosures – especially corporate ones – are discretionary and often unsupported by rigorous data, and while ESG rating frameworks for equities are developing and the IFRS Foundation has recently announced a continuing initiative to create new reporting prototypes , ESG-linked private and public sector bonds are still a very small fraction of securities in issuance and the market is fragmented.

So just as ESG investing has gained traction, the gap between ambition and verifiable compliance has widened. Regulations are not widely understood, and reliable data on which to base decisions is scarce. In our latest survey, 59 per cent of respondents in Europe said that data – or the lack of it – remains the biggest barrier to integrating ESG into their investment processes.

The data challenge extends across industries and asset classes, and it is becoming more acute. Investors are moving beyond the early phase of ESG adoption, which focused on excluding some assets and labelling others green, towards more nuanced thematic investment strategies. Full ESG integration will demand granular data that can inform decisions on carbon and other environmental impacts, and highlight the social consequences of real-world businesses. Alternative and non-listed assets, where disclosure requirements are low but investor appetite is growing, present a particular challenge.

> To drive these changes home, they need a scalable ESG data model that can support their operations

Time for solutions

The BNP Paribas ESG Global Survey 2021 shows that investors are moving decisively from learning about ESG investing to putting it into effect. They have typically identified their base-level compliance requirements for the EU's Sustainable Finance Disclosure Regulation (SFDR) and have conducted compliance risk assessments. Moreover, they have begun to move towards making ESG an operational investment model, integrating ESG targets into their investment strategies, decisions and marketing.

But to drive these changes home, they need a scalable ESG data model that can support their operations. They need to ingest and analyse data across a huge range of subjects, in many formats, using hundreds or even thousands of data points, and make it serve their ESG strategies.

This is what BNP Paribas Securities Services' Manaos data platform offers. Manaos, which has won multiple awards for innovation, stands out from existing data solutions by providing a single point of access to a universe of third-party data providers, selected by the user, with all data feeds integrated into a single interface. All the data can be analysed in the background according to parameters set by the user. Manaos works across asset classes, geographies and regulatory frameworks, whatever ESG methodologies are used.

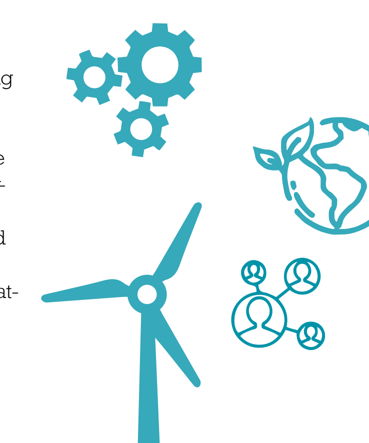
This multiple-source, data-market approach is effectively an evolving ecosystem of applications and providers, not a preconfigured tool. It creates a customisable data model, offering multiple advantages including price transparency. Users avoid having to invest time, money and IT resources in their own ESG data infrastructure, and don't have to become dependent on limited but costly outsourced solutions. Manaos creates a single platform source of reliable information available to investment, risk, marketing and regulatory teams who today generally rely on their own, often incompatible, databases.

> This multiple-source, data-market approach is effectively an evolving ecosystem of applications and providers, not a preconfigured tool

This is a data solution engineered for change. Few aspects of investment are evolving as rapidly as the ESG arena, so the Manaos data market model is designed to be inherently flexible and adaptable. We believe this is the best solution to the challenge of sifting through incomplete and inconsistent disclosure and across multi-source, multi-format data streams to build the fullest picture possible of ESG performance and compliance.

Our latest survey results say it loud and clear: this is what investors know they are missing, a data gathering platform that will support transformative sustainable investing ambitions. ✤

Patrice Hiddinga,
Chief Executive Officer, Manaos
Manaos is a subsidiary of BNP Paribas Securities Services



THE RISE & RISE OF THIRD-PARTY CLEARING

Written by **Mark Wootton**, Regional Head of Local Custody and Clearing Asia-Pacific

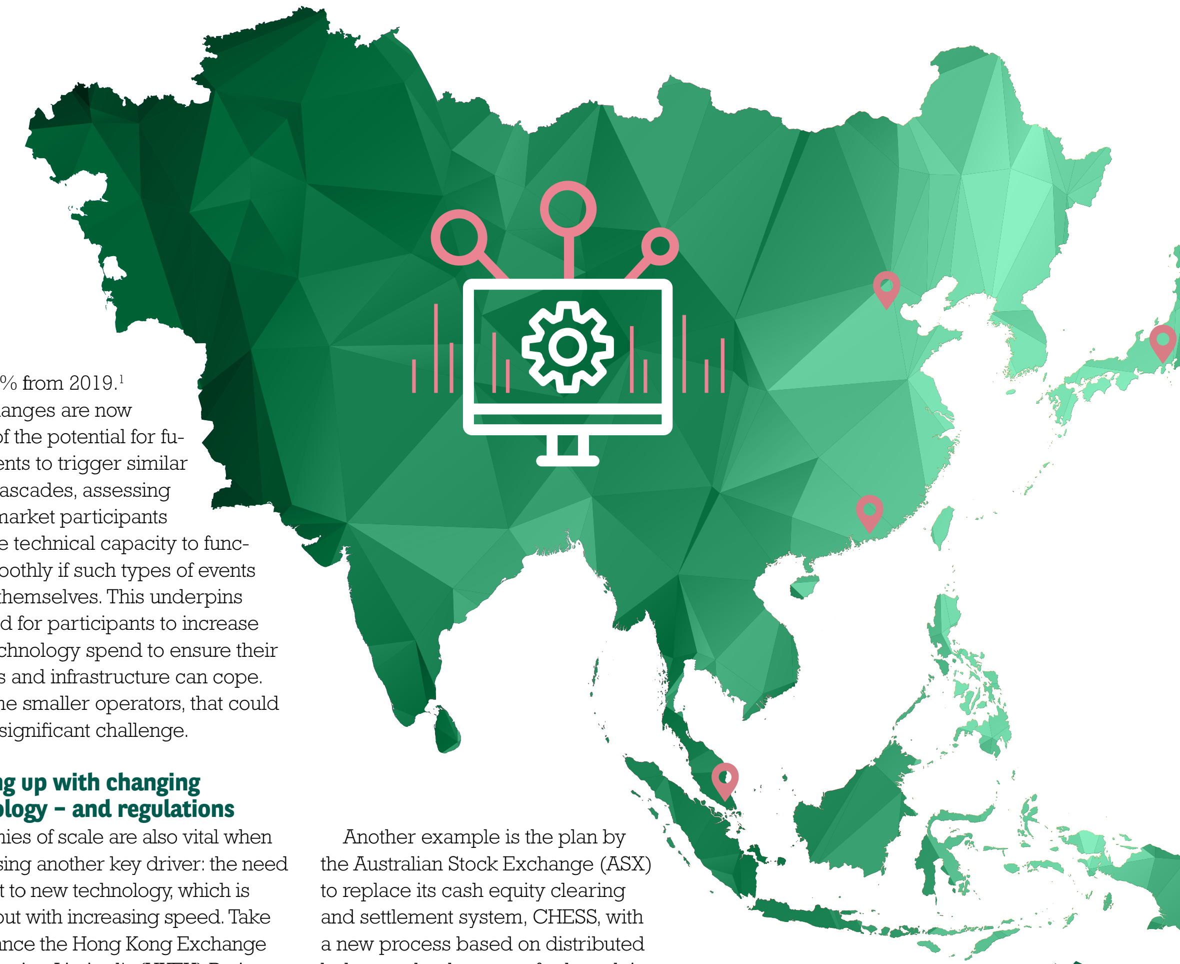
In recent years, the demand for Third-Party Clearing (TPC) in Asia Pacific (APAC) has risen strongly, with brokerage firms shifting away from account operator or self-clearing models, and handing responsibility for clearing and settlement to external service providers. While the region is behind the likes of Europe in adopting TPC, demand for the model continues to gain momentum.

Several factors underpin this trend, not least regulatory and technological changes across APAC that have made clearing an increasingly complex and challenging process. The obligation to keep pace with these requirements falls on clearers and, with more changes on the way, the requirements will only increase. Here we set out the main drivers that are pushing brokers in APAC towards the TPC model and assess the factors they need to consider when outsourcing the function.

Prepared for increasing volatility

The volatility seen during the early stages of the COVID-19 pandemic was a wake-up call for many market participants within the region. Trading volumes and volatility rose sharply, leading to rising revenues for brokers but also settlement and clearing challenges across markets. While the extreme volatility of March 2020 subsided reasonably quickly, APAC markets saw steady increases in trading volumes, which for cash equities ended the year up 49.7% from 2019.[1]

Exchanges are now aware of the potential for future events to trigger similar order cascades, assessing which market participants have the technical capacity to function smoothly if such types of events repeat themselves. This underpins the need for participants to increase their technology spend to ensure their systems and infrastructure can cope. For some smaller operators, that could pose a significant challenge.



Keeping up with changing technology – and regulations

Economies of scale are also vital when addressing another key driver: the need to adapt to new technology, which is rolling out with increasing speed. Take for instance the Hong Kong Exchange and Clearing Limited's (HKEX) Project Synapse, the new integrated settlement platform set for launch in 2022. It uses smart contract technology to standardise and streamline post-trade workflows for northbound trades under Stock Connect, which links Hong Kong's stock exchange with those in Mainland China.

> While technological advances like these promise considerable speed and efficiency gains, they inevitably mean that participants must boost their technology spend.
>
> A large tier 1 bank

Another example is the plan by the Australian Stock Exchange (ASX) to replace its cash equity clearing and settlement system, CHESS, with a new process based on distributed ledger technology –set for launch in April 2023. As well as speeding up and streamlining clearing and settlement, the new system will allow for interaction through upgraded messaging protocols (to include the ISO 20022 standard) or directly through a new API connection.[2]

As well as these pilots, HKEX may well look at further changes post the roll out of Synapse. Singapore Exchange Ltd (SGX) has been refining its new settlement system (SGX-PTS WEB), shortening trade settlement times, meanwhile India's financial regulator is reviewing interoperability across exchanges.[3]

While technological advances like these promise considerable speed and efficiency gains, they inevitably mean that participants must boost their technology spend; in some cases upgrading or replacing legacy platforms, infrastructure and connectivity. They also lead to increased compliance costs, as brokers must keep pace with myriad accompanying regulatory changes across APAC.

"BNP Paribas Securities Services has the team who prove to us every day that they can take care of all our clearing needs – even on massive

1. World Federation of Exchanges, 2020 Market Highlights
2. KPMG, "ASX extends timetable for CHESS Replacement", July 2020
3. Economic Times, "NSE glitch leads to revamp of bourses' interoperability system", April 2021

trading volume days.

Trusting them to do all the regulatory reporting and handling IT upgrades to meet the changes at market/exchange level means our team is able to concentrate on what we do best – and that's finding the right trading opportunities to generate alpha for our clients.

BNP Paribas Securities Services has enabled us to achieve efficiencies we would not have been able to on our own.''

Large tier 1 bank
The widening appeal of TPC

Outsourcing, conversely, means brokers need not seek budget to fund new technology and compliance costs, easing the pressure to raise back-office expenditure. Instead, they can focus on core trade-execution competencies.

The appeal of this model is magnified by the impact of other trends. Fee compression, for example, has made it more difficult to maintain the status quo. Then there is the liquidity impact: brokers need sufficient core capital to cover trading activities and margin requirements – and often in multiple currencies for different jurisdictions. Meeting those across multiple markets drains liquidity and ties up capital.

To date, TPC has benefited participants of a certain size and operators that offer services across multiple markets, including offshore brokers based in one jurisdiction and executing in another where they may not have a local presence. However, this is starting to change. Some large organisations use TPC as they focus on their core strengths and key objectives – assessing which tasks are best carried out in-house and which are worth outsourcing.

The demand for TPC is also starting increasing across asset classes, including cash equities and derivatives. Its benefits hold true for organisations that run self-clearing operations (where they are a direct member of a clearing house and must meet the operational requirements and obligations like core capital needs) and those with an account-operator model (where they are a member, but another party fulfils the operational requirements).

> The appeal of this model is magnified by the impact of other trends. Fee compression, for example, has made it more difficult to maintain the status quo.
>
> A large tier 1 bank

Refocus on core strengths

Using a TPC solution means clients avoid many of these challenges and mitigate many of the associated problems – assuming they partner with the right provider. Using a supplier of the scale of BNP Paribas Securities Services means they can benefit from our on-the-ground expertise in APAC (and globally) covering all aspects of clearing – regulatory, technological and operational – as well as from our continual investment in technology, our multi-asset class-outsourcing services and our strong balance sheet.

We have also been at the cutting edge of many of the regulatory and technical developments in the region: e.g. participating from the initial stages of both the ASX CHESS replacement program and by being a pilot participant for HKEX's Synapse project. We are actively expanding the development of TPC solutions across the region: we expect to go live with our cash-equity TPC model in New Zealand in H1 2022, demonstrating our efforts to meet the increasing demand for outsourcing across APAC.

The economies of scale we deliver also means clients can benefit from our buy-side and sell-side capabilities that allow us to further internalise transactions and reduce costs.

Finally, from an industry perspective, clients can leverage our position as one of the world's largest financial services participants. This means their voices will be heard through our advocacy on their behalf, as we continue to play a leading role in industry-defining changes. Ultimately, these qualities all help achieve the aim of any outsourced solution: to enable clients to focus on their core strengths.