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BNP Paribas breaks cover as Europe's best bet

BNPP's latest strategic update for its corporate and institutional bank might have fallen short of the expectations of a market now used to the wild lurches of rival European firms. But to dismiss this as mere tinkering would be a mistake. It builds on an already bold and long-held plan. And, crucially, it is one the bank's leaders say they can afford

By: Mark Baker **Illustration:** Stephen Lee

Barely five minutes after sitting down with Euromoney, Yann Gérardin, head of corporate and institutional banking at BNP Paribas, has to take a call on the retro Samsung mobile phone his children like to make fun of. Jean-Laurent Bonnafé, chief executive of the bank, wants to discuss the approval of a big credit commitment to an important client.

The interruption is instructive. This is a bank willing to extend sizeable credit, but only if doing so fits in with its vision for the entire firm. At BNPP, the idea of a standalone corporate and investment bank strategy is anathema.

When Euromoney speaks to him, Gérardin has just come through the full-year 2015 reporting cycle that has seen him present the latest strategy for the CIB division, the 2016-2019 Transformation Plan, alongside the bank's annual results. Those results provided a strong backdrop: CIB revenues rose 13.2% to €11.6 billion, with pre-tax profit up 17.9% to €3.3 billion.

Gérardin told analysts on a February 5 conference call that CIB now had "a solid and profitable platform ready to act out of strength". It had improved its global position thanks to gains in market share and had seen progress in the US and Asia Pacific as well as reinforcing its European franchises.

At group level, the bank has already surpassed its €3 billion revenue target for Asia Pacific one year ahead of the schedule dictated by the current 2014-2016 plan.

The new plan builds on the previous one and on the new governance structure that Gérardin put in place for CIB in late 2014, when the division was renamed from corporate and investment banking to corporate and institutional banking.

It has its origins in an even earlier "adaptation plan" that BNPP put in place in 2011 in the wake of the eurozone sovereign debt crisis. That effort saw the bank slash risk-weighted assets as it sought to achieve Basel III compliance quicker than peers.

The flexibility now afforded the bank by those early moves is a theme that Gérardin returns to frequently, both in his comments to analysts and in his discussion with Euromoney. For him, it has paved the way for all that has followed.

THE FIRST LEVER OF THE LATEST PLAN IS DUBBED 'FOCUS', and is intended to see capital and balance sheet shifted from unproductive to productive areas, resulting in a trimming of some businesses, geographical scope and clients in favour of new opportunities principally created by the retreat of struggling competitors.

Within this leg of the plan, risk-weighted assets are being cut by €20 billion, with some €12 billion of that coming from the wind-down of short-maturity legacy asset securitization positions within global markets. A further €8 billion is coming from the corporate loan book. This will all be accompanied by a €10 billion reinvestment to support the bank's pursuit of market-share gains.

The second lever, 'Improve', targets some €1 billion of cost savings by 2019, mostly through improvements in operational efficiency. Finally, 'Grow' will look to develop those businesses that are less capital intensive than others and are strong fee generators. These include the securities services, transaction banking and cash management businesses that were brought into the scope of CIB in 2014, as well as advisory.

Gérardin told analysts that success by 2019 would see the CIB having grown revenues by at least 4% each year, while reducing the cost-to-income ratio by eight points, generating an additional €1.6 billion in pre-tax profit, compared with 2015.

Not everyone shares his optimism that the targets can be hit. But BNP Paribas has made a habit of meeting targets in recent years in ways that many of its competitors might view with jealousy.

At group level, the four targets it set as part of its 2014 to 2016 development plan have largely been hit already: revenue growth up 10%; cost savings of €2.8 billion; return on equity of at least 10%; and a fully loaded Basel III capital ratio of 10%.

That's perhaps why Bonnafé exudes a quiet confidence when the doubts over the deliverability of the CIB plan are put to him. And he is not one of the European bank leaders, such as his close counterpart Frédéric Oudéa at Société Générale, Barclays chairman John McFarlane or Credit Suisse CEO Tidjane Thiam, that have publicly bemoaned the increasing dominance of US investment banks.

He shrugs when asked why that is, as if the question is slightly redundant. After all, if US banks have increased European market share in some areas, so has BNPP. According to corporate banking and cash management studies by Greenwich Associates in 2015, some 60% of European companies with at least €2 billion in turnover use the bank for corporate banking and 38% for cash management, results that the analysts said put the bank "comfortably ahead" of competitors in both businesses.

"We used to be a top-10 player in European cash management. Now we are the top cash manager," says Bonnafé. "It's the same story in trade finance, factoring and leasing. We're confident we can continue to gain market share through organic growth as set out in our medium-term plan."

FOR GÉRARDIN, THE VISION OF HOW an investment bank should be run stems from his experiences at the toughest time in his career. He joined BNP in 1987 and, tucked away in a corner of the dealing room, set about creating an equity derivatives desk. By 1999, after the bank's merger with Paribas, he was global head of a growing business. By 2005 he was running all of the equities division too.

Elsewhere there was trouble brewing.

BNP Paribas was famously the canary in the coal mine when it came to the US subprime debt crisis that quickly ballooned into a broader systemic threat to the global financial sector. The announcement on August 9 2007 that the bank was suspending net asset value calculations on three of its asset-backed securities funds because of "the complete evaporation of liquidity in certain market segments of the US securitization market", is etched in the minds of many.

The subsequent crisis was something of an epiphany for Gérardin too. But unlike those who opted to double down in early 2009 across a number of asset classes to catch the opportunities afforded by a surge in volatility, Gérardin chose to cut costs, RWA and funding – the logic being that the market was unlikely to help banks make the adjustment to Basel III.

"For me the transformation of the equity business started on January 1 2009," he says.

Gérardin traces the origins of how BNP Paribas now approaches its broader corporate and institutional bank firmly back to that experience.

"I decided then that there should be a change in priority," he says. "It was no longer possible for anyone to run a corporate and investment bank as a standalone strategy. It had to be aligned with the key areas of strength of the group."

Part of that strength is the diversity of the group, with European retail banking, the CIB and the investment solutions divisions each providing relatively equal weight to group earnings. And there's tradition as well.

"We can't say to our clients that we are exiting parts of the business. You can't offer a guest coffee or tea, but say there is no water. If you are serving your clients, you have to deliver the full suite of products they need"

Jean-Laurent Bonnafé

"Our history as a bank is to be client-centric. So the new climate for corporate and investment banking suits us," says Bonnafé.

It's hard to find a bank that doesn't say something similar now, of course. The difference, says Gérardin, is that BNPP can actually afford this strategy – and can still pitch itself as wholeheartedly serving both its key client constituencies.

Having moved earlier than some to shed costs and risk, and having recognised quickly that all parts of the bank would have to serve each other in a capital-constrained future, BNP Paribas has been able to avoid the undesirable choice between primarily serving either corporates or institutions that Gérardin argues competitors have been pushed into, even when they profess to want to sit right in the middle.

And it stands in a better financial position than them to do so.

"It is very rare to be able to entertain both sides at the same time, but that is exactly what we want to do – and we can afford it," says Gérardin. The bank's CIB division has among the highest pre-tax notional return on equity numbers in the sector, at 18.6% as of the full year 2015, a performance that Gérardin says puts it top of its European peer group and in the top three globally.

That comes in handy when competitors are stuck in the vicious circle of cutting to respond to regulatory pressures while also dealing with the relentless drip of fines that erodes earnings. BNPP had one calamitous regulatory incident: the $9 billion sanctions-related settlement in the second quarter of 2014 took the group to a hefty loss for the period. That was only the second quarterly loss in the bank's history.

As a result, Gérardin considers the bank to have more flexibility than some. "To use an analogy from my equity derivatives background, some banks have been forced to give up their option on having both a corporate and institutional client base. But we get to keep that option."

THE KEY THEME BEHIND THE approach that the bank has chosen is disintermediation, where traditional lenders are increasingly side-lined in favour of market-financing solutions, a trend that will only grow as the European Union's planned capital markets union – a pan-European single market for capital that aims to better mobilise savings for the benefit of those that need financing – takes hold.

For Gérardin, this presents more of an opportunity than a challenge, particularly as the bank has built its CIB strategy on acting as the bridge between corporates and institutions. That first strategic plan that Gérardin announced after taking the helm of CIB in late 2014 saw the division renamed from corporate and investment banking to corporate and institutional banking. For the bank this was no mere presentational detail, but reflected the philosophy underpinning the new approach.

As part of that 2014 plan, the processing businesses of securities services and cash management were brought into CIB. Again, this was a critical part of the preparation for a disintermediated world, where what matters is not only understanding the needs of both institutional and corporate clients but also being able to service them.

"The best way to strengthen our relationship with an asset manager is through securities services, to be their custodian," notes Gérardin.

It is a similar story on the corporate side with cash management, where a referral deal struck with Royal Bank of Scotland in 2015 has seen more than 900 new clients brought into BNPP's cash management business – all of which are potential clients to be plugged into the bank's other platforms.

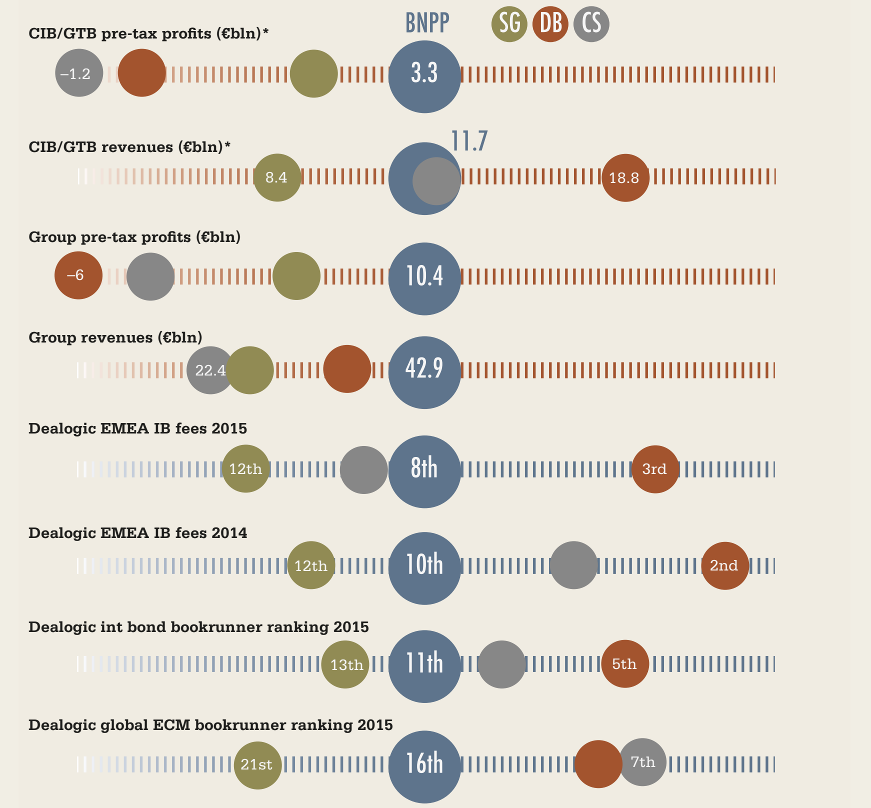
"Taking on 900 of RBS's cash management and trade finance clients to date has given our whole CIB business in countries such as Germany, the UK and the Netherlands a big boost," says Thierry Varène, chairman of corporate clients financing and advisory EMEA. "We are pleased to show those clients that we provide the operational support they need and follow them in their development. That allows us to know our clients better and to engage in a strategic dialogue to provide additional services and solutions around financing and advisory."

Then there's the retrenchment of the banking industry as a whole. "Clients are concerned about the implications of lower commitment from their banks," says Gérardin. "They know resources are scarce."

Against that backdrop, the CIB head sees the new strategic plan as building on the previous one, with an additional top-down approach being layered onto the original bottom-up one. The earlier rejig put in place the building blocks for where he now wants the CIB to end up as the environment shifts. "Where do we want to go? This comes back to our vision, that the European economy will become more and more disintermediated and we must be there to play a leading role."

Stacking up

BNP Paribas vs Société Générale, Deutsche Bank and Credit Suisse



* Comprises: CIB at BNP Paribas; CB&S and GTB at Deutsche Bank; GMIS and F&A at Société Générale; IBCM, GM, SUB (C&I) and Apac IB at Credit Suisse
Sources: Bank results announcements; Dealogic

THAT IS NOT TO SAY THAT THERE have not been changes to what BNPP can or is willing to do. As at many competitors, there is no burning desire for long-dated, highly structured exposures. Anything deviating much from short-term vanilla would need to be absolutely vital to a key client if it were to be considered, and even then the bank is comfortable saying it is impossible.

Even in a disintermediating world, the provision of credit is still an important part of business, but this too must work harder for the rest of the bank. The lending discussion with Bonnafé is part of that process, and the bank has also created a large resources allocation group that looks at needs across the whole group. Historically decisions like this were made on a much more siloed basis.

Such an approach to where it makes sense to do business has meant cutting clients, as Gérardin concedes. But this has not been a severe blow, affecting mostly those that are mono-product or who have historically not been paying the true price of credit.

It's not just capital requirements that pile on the pressure. Regulatory know-your-customer requirements are more onerous than ever: annual costs of up to €50,000 a client are not unusual these days.

Since the late 2014 plan was put in place, there has been much behind the scenes work in improving efficiency within the CIB structure, including the creation of an integrated corporate debt platform that brings investment-grade DCM and loan origination closer together. High-yield debt and leveraged loans are also now better aligned, while bond and loan syndicate functions are more integrated. All this has been accompanied by the injection of cash management and securities services into the corporate and institutional bank.

There are also areas where the bank needs to build further. It has long been a leading bank for euro bonds, but high-yield debt and securitization are two businesses where Gérardin wants to build BNPP's presence. It's not necessarily about being number one, but it is important to be sufficiently diversified on the primary side, both in terms of product and geography, to be able to service the clients the bank wants to keep – something that plays back into the disintermediation theme.

In this context, staying away from esoteric secondary risks is one thing, but not bothering with a particular primary product is not an option. While a typical mid-cap might have only been seeking credit from a bank even five years ago, today it might well also consider a high-yield bond, for instance.

"Our clients' needs have changed. We need to be fully equipped to understand their needs and to deliver solutions across all product areas and geographies," says Gérardin. "European high yield is one to watch in global credit. In order for us to offer high yield to our clients, we need a strong, geographically diversified platform. In that respect, having a presence in the US is essential."

Or, as Bonnafé puts it: "We can't say to our clients that we are exiting parts of the business. You can't offer a guest coffee or tea, but say there is no water. If you are serving your clients, you have to deliver the full suite of products they need."

"Some banks have been forced to give up their option on having both a corporate and institutional client base. But we get to keep that option"

Yann Gérardin

SOME ANALYSTS STILL DON'T BUY IT, though, and equity investors are a struggle to convince too, despite that track record of hitting its targets. As of mid-February, the bank's stock was down slightly from the latest results announcement on February 5. But it has nonetheless performed better than the sector over that period, at a time of considerable stress amid renewed questions over the long-term picture for banks' additional tier 1 capital. The shares are down about 20% in the last 12 months and based on the most recent quarter, the bank is trading at half book value. Shares of Credit Suisse and Deutsche Bank have dropped more than 40%, Société Générale by 27%, Crédit Agricole by 35%.

The analyst conference call that followed the latest results had a generally favourable tone. Many questions focused on capital and the ability of the bank to continue to deliver return on equity targets even while increasing its core equity tier-1 ratio. But scepticism at the predicted performance of the corporate and institutional bank was also detectable. A February 9 research report from Berenberg captured that feeling, characterising the firm as a growing fish in a shrinking pond.

"BNP's plan to grow CIB by taking market share from retrenching competitors is based on an unrealistic view of the operating environment," it said. "We think that CIB revenues are in structural (and cyclical) decline and that rising capital requirements will continue to erode returns in these businesses. […] We see BNP's plan as unrealistic and reliant on leverage." Berenberg's price target on the stock was €25.00, 36% below where it was trading at the time.

Reliance on leverage seems an odd accusation to level at a bank that delivered growth in 2015 while also cutting its leverage exposure by €166 billion (to €900 billion), notes one insider. But there are also more fundamental differences of opinion between the bank and observers. On the call discussing the recent results, Gérardin said that he expected the global CIB revenue pool to increase by 1% to 2% annually in the future, which the Berenberg analysts not only disagreed with but also said they failed to see "how BNP can be insulated from these trends relative to peers".

Moreover, a typical sum-of-its-parts approach to valuing the business doesn't necessarily capture the value of the model, because it neglects the strength of the whole.

"The integrated banking model is more powerful today than it has ever been," says Gérardin. "In the context of a general trend towards disintermediation in the financial markets, our diversified and integrated business model is an important strength."

A good chunk of revenues come from business that CIB clients give to other parts of the bank. That's important, given how expensive – but indispensable – the front office of a CIB is. "Cross-selling is at the heart of our integrated model," says Bonnafé. "Globally it represents 20% of our revenues."

At least part of the reason for some observers' resistance to the message is probably to do with communication. The bank has not had quite the same image problem that some argue was created by the tendency of John Cryan, Deutsche Bank's newish co-CEO, to focus on the negatives facing his bank when he took over.

But BNPP's unwillingness to trumpet its successes as much as some others does have a downside when it comes to convincing people to embrace its strategy.

Gérardin speaks of a culture that promotes itself "modestly and with humility" – he uses the phrase twice in conversation with Euromoney – and his confidence that the bank can and will take market share from suffering competitors is probably as close as it is possible to get to bragging at BNP Paribas. Bonnafé, meanwhile, wears the even more understated profile of a man who has grown up through the retail bank and is an engineer by training. He is not given to grandstanding.

Some of the disappointment is also doubtless of the market's own making. Amid turbulent change at the likes of Credit Suisse and Deutsche Bank, equity investors have come to expect violent shifts in strategic direction – often accompanied by a dramatic scaling-back of ambitions. In that respect, BNPP doesn't fit the narrative.

It was known in the market that consultancy firms Oliver Wyman and Boston Consulting Group were helping the bank devise its strategy, something that surely elevated the anticipation. Were it not for those expectations, the bank might not even have announced any update to its CIB strategy until next year, when its current three-year plan is set to be refreshed with a new path out to 2020. There will be more "fine-tuning" to come for the 2020 plan, says Gérardin, but for the cynics there is still an inescapable sense of 'Is that it?'

AS IT TURNS OUT, THE 'IT' IS A PRETTY big deal in the eyes of BNPP's senior management. Not only is it implementing a strategy that it sees as unique among European banks, but one that has been a conscious iterative process over years, rather than forced upon it by a sudden realisation that the alternative is disaster.

"This is a multidimensional plan that can be adjusted if conditions in certain markets or sectors change," says Gérardin. "The key is to maintain discipline and focus. We did not want to wait until the end of 2016 to clarify our strategy. We did not want shareholders and clients to think we were in denial of the reality of these markets and this environment. But the truth is, the reality of our own situation is different to many of our competitors."

The bank has been helped by the fact that the environment – capital-constrained, favouring nuts-and-bolts corporate banking and transaction services with only a modest overlay of funky capital markets products – has more or less caught up with much of what BNPP was already doing. Others, the former flow monsters or those that used to be in the business of buying league table in primary markets to be able to show market share even at the cost of profitability, have been bigger and more unwieldy ships to turn around.

"We are smaller and leaner than many of our peers and so we are easier to transform," says Gérardin. "We are working to a plan. In the first instance, we set out our vision, then we outlined our strategy, and now we are in the transformation phase. Others are being forced to transform without a clear strategy."

He argues that loyalty and consistency of senior management is also a factor that is often overlooked. He joined in 1987, and Bonnafé in 1994. Other executive committee members are even more long-serving: Jacques d'Estais, a former head of the investment bank and now deputy chief operating officer of BNPP Group, joined Paribas in 1983.

That stability has served the bank well, steering it through crises including troubled eurozone sovereign-debt exposure and the subsequent dollar funding crisis that struck French banks in 2011 when US money markets took fright. Some outside Europe recognised the attraction of looking to BNPP for a European banking partner in the wake of the sub-prime crisis, as they fretted about their traditional banks' willingness or ability to service them outside their home markets.

As far back as 2009, BlackRock CEO Larry Fink was one who approached BNPP for insight into opportunities in Europe, having mostly relied on US firms until then, but feeling that the crisis engulfing the sector would drive a need for more partners elsewhere.

That kind of pulling power is what helps convince the bank that it can indeed take share from others. Gérardin says that many of the market share gains it hopes to notch up will inevitably come from what is given up by European competitors in the US and Asia as they pull back from global ambitions. That said, Europe is still important and will continue to be the main engine.

"We are first and foremost a European bank," he says. "As 60% of our costs and 60% of our revenues are in Europe, success in this market is key."

Germany, with a highly regional and fragmented corporate and retail banking sector alongside an investment bank that is undergoing radical change – Deutsche Bank, is one market where BNPP could increasingly service a corporate sector that needs a comprehensive regional offering. It will hope to make good ground by leading with cash management there, but institutional clients will be keen too.

The opportunity that the bank has is well recognised by competitors and former executives. "I would say that BNPP is arguably the only pan-European bank, although Santander I see as a possible challenger, with its Spanish, UK and German presence," says one former investment banking CEO.

Gérardin says another benefit to the firm is that, unlike at some of its peers, he and his senior management are able to set out a clear direction of travel for the business. "Our employees know what we are doing, and that's very valuable."

A challenge, however, will be for BNPP to stay focused on maintaining share in its home markets while pushing elsewhere, something that will be made doubly difficult by competitors choosing to retrench to their own home markets.

Senior bankers at BNPP say they have been under intense pressure in the last year to ensure that any areas where the bank felt it was starting to lose market share domestically were quickly repaired. A more rigorous management focus has been seen in some business lines as a result.

"Put simply, there are some on my team that do not like me as much as they did two years ago," says one asset class head at the firm.

The prospect of emerging as one of the few pan-European universal banks might be expected to please Bonnafé and Gérardin. Not so. They might want to be the best – and they certainly want to take market share – but they have little interest in being the last man standing.

"The European competitive landscape is changing," says Gérardin. "There are fewer counterparties and this could have a significant impact on the future financing of the European economy."

That concern is perhaps what helps to rein in any temptation to be triumphalist at BNPP, and with good reason. But while modesty and humility may prevail, competitors and analysts should not doubt the commitment behind the firm's ambition.