Talking Heads with Paul Xatard-Huberlant

Andrew Craig: Hello and welcome to this week's BNP Paribas Asset Management Talking Heads podcast. Every week, Talking Heads will bring you in-depth insights and analysis on the topics that really matter to investors. In this episode, we'll be discussing the role exchange-traded funds, better known as ETFs, can play for investors investing cash, whether it's placed placing cash on an overnight basis or for short periods where liquidity and the stability of returns are paramount. I'm Andy Craig, Co-Head of the Investment Insight Centre, and I'm joined today by Paul Xatard-Huberlant, who's Head of ETF and Index Management in the Systematic and Quantitative Investment Group at BNP Paribas Asset Management. Welcome, Paul, and thank you for joining me today.

Paul Xatard-Huberlant: Thanks, Andy. Good to be here.

AC: Cash management is a crucial part of any investor's portfolio, and we continue to see huge interest from clients in short-term money market management. What makes these investments so important and so attractive?

PZ: Historically, investors wanted to invest positive cash balances for a short period of time in money market funds or other money market instruments. They were – and still are – looking to get a yield on uninvested liquidity. We don't want money parked doing nothing. We want to put it to work and make sure that cash and any spare liquidity is generating a return.

Let's first define short-term money market investments. These are financial tools that help manage cash over the short term and provide a high degree of liquidity. This mean the investment can be cashed in easily, be diversified to spread risk, and the value of the principal invested typically remains stable, while the investment offers a market-based yield. So, the main features are liquidity, diversification and stability.

AC: Who use these money market instruments?

PZ: The main investors are treasurers, companies, insurers, fund managers and asset allocators. Managers of fund of funds strategies also use money market instruments.

AC: It strikes me that, basically, virtually all investor types need money market investments. We know they're in a very uncertain world. We know also interest rates have normalised, so they're an attractive investment, particularly if investors are worried about what might be coming around the corner.

PZ: Exactly. The appetite for these investments depends on the level of interest rates. In an environment in which interest rates are low, investors will probably look at other solutions to improve [the] performance of their spare cash. So, this is always an important area for investors. What's interesting is that ETFs have expanded the range of solutions that investors have at their disposal.

AC: That's the big change, isn't it, that ETFs are bringing to this business.

PZ: Over the past two years, we have seen a trend in synthetic money market products. Synthetic means that the investment of the fund is not in a money market instrument physically, but rather in a basket of equities, for example, whose performance is swapped against the reference rates that the fund tracks. So, synthetic money market products offer investor the same pay-off as well as an extra yield, at least in recent market conditions.

AC: What sort of investors are you seeing taking advantage of this new facet of money market management?

PZ: Basically, these are the same investors that use synthetic replication. You can do it in two different ways. Either the standard ETF providing daily liquidity or you have investors that will need a kind of guarantee or a requirement to lock in the highest rate possible. This is mainly done via mandates or dedicated funds. Over the past two years, we saw strong inflows in both ETFs and dedicated funds. The ETF part of the business now amounts to dozens of billions [of euros] of assets.

AC: Let's go back to synthetic money market products and look at the synthetic element. This is important to distinguish the physical from the synthetic. So, in synthetic replication, the manager takes out a financial contract known as a swap with a counterparty that will deliver the financial performance of an index or, in the case of money market instruments, of the benchmark rate of a certain geographic area plus an extra yield. The big advantage of doing this is that the transaction costs are lower than having to buy and physically replicate instruments. If you've got lower transaction costs, that's reflected in the return for the investor. Is that right?

PZ: It is one of the features of this kind of replication. Synthetic ETFs have also different operational and execution characteristics compared to traditional products. But at the end, they will deliver the same exposure with a similar pay-off.

AC" Let's talk about how you manage synthetic replication in an ETF. How does synthetic index replication for ETFs and index funds work within your team?

PZ: At BNP Paribas, we have been using synthetic replication in our exchange-traded fund and index business for more than 15 years and we currently manage around €13 billion of assets in this replication methodology. Historically, there is a strong trading expertise at BNP Paribas Asset Management within the ETF and index team. We are working with a pool of reputable banks as counterparties to deliver performance across different exposures, developed or emerging markets, geographic areas and recently synthetic money market exposure.

AC: So, this is very important: Your team has a long experience, you have a lot of expertise, you look very closely at counterparties because risk is crucial ultimately for the investor.

PZ: Yes, this is correct. Risk is at the heart of our process, and we have a strong framework to monitor the risk at different levels. Counterparty risk is of course the main identifiable risk. Over time, regulation has evolved. Our swap activity should be now collateralised and framed by up and down-limits.

AC: As I said previously, it's the fact that this can be done cheaper and far more easily than actually having to buy a whole range of money market instruments that's basically at the heart of the advantages of what you're doing. It's interesting to understand more about this new solution for investors looking to put their cash to work. It seems to me it's a major change within what's on offer for cash management with a lot of reasons why investors should look at it closely. So, thank you for taking us through this feature of ETFs.

PZ; Thanks a lot for the invitation.

AC: That's it for this week's episode of Talking Heads. If you'd like to learn more about ETFs for cash management or any other of our investment insights, please reach out to your BNP Paribas Asset Management contact or check out Viewpoint, our website for investment insights at viewpoint.bnpparibas-am.com. We recommend subscribing to Talking Heads on your favourite podcast channel such as YouTube or Spotify. You'll receive your podcast episodes every week. If you like Talking Heads, please leave us a positive review and a nice rating. You've been listening to the BNP Paribas Asset Management Talking Heads podcast with me, Andy Craig and Paul Xatard-Huberlant, Head of Equity ETF and Index Management in the systematic and quantitative investment group at BNP Paribas Asset Management. Please do join us again next week. Until then, take care.