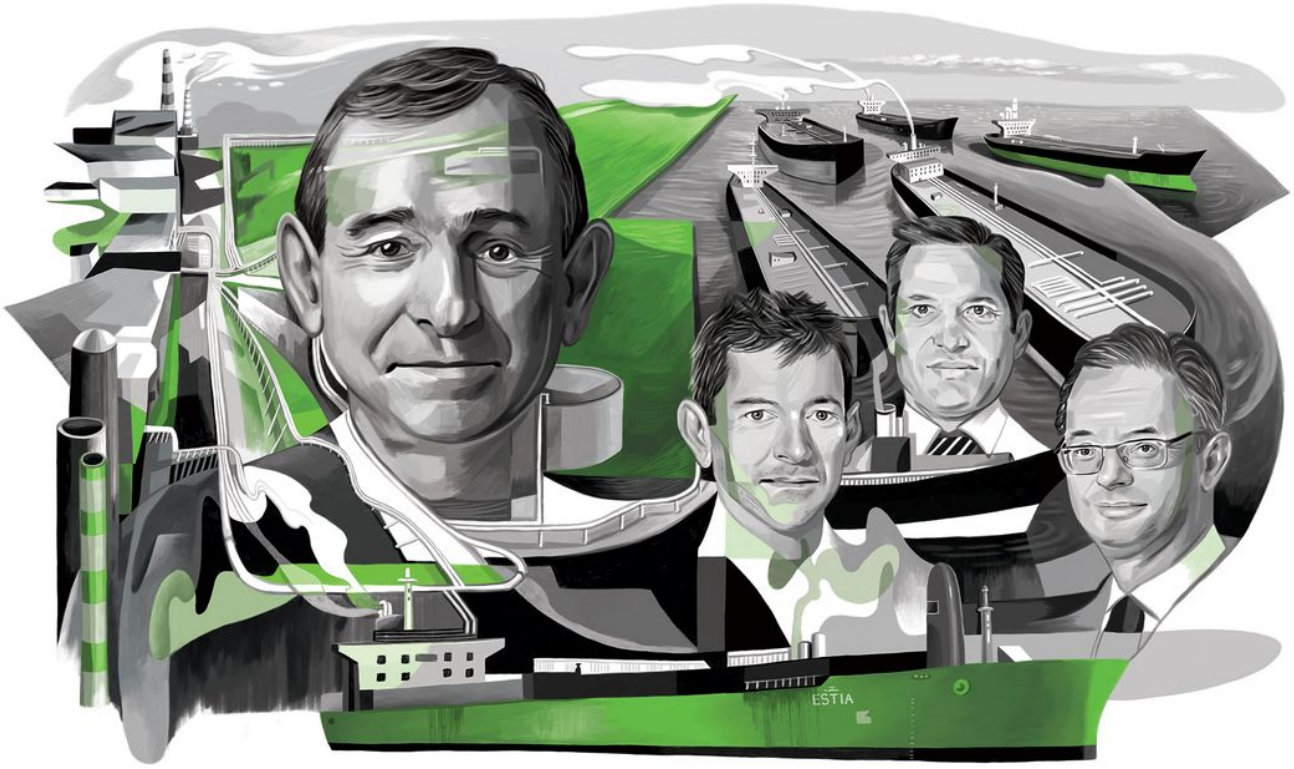
What Makes $1 Billion a Year and Oils the Global Economy While Rebuilding Its Reputation?

Trafigura, the commodities trader, has been seeking redemption ever since its toxic-waste spill a dozen years ago.



From left: the late co-founder, Claude Dauphin; the new team, Mike Wainwright, José Larocca, and Jeremy Weir.
Illustration: Gel Jamlang for Bloomberg Markets

By **Andy Hoffman** and **Javier Blas**

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From

It's a quiet scene, but there's more to it than meets the eye. The *Estia*, a 751-foot-long oil tanker, is loading gasoline on a breezy afternoon at port in Vadinar, a town in northwest India. The Bahamas-flagged ship has journeyed from Singapore to this hulking dock on the Arabian Sea, where a relentless afternoon sun bakes the concrete jetty. Through pipes connected to loading arms reaching some 66 feet high, the *Estia* is taking on 55,000 tons of gasoline from one of Asia's largest and most modern oil refineries.

The 40-hour-long loading operation is just one of the hundreds of daily tanker movements that underpin the multibillion-dollar global petroleum market. Yet this one isn't being undertaken by any of the household names that dominate the oil industry of the popular imagination—Exxon Mobil, say, or Chevron or Royal Dutch Shell. The jetty, the ship, and the giant refinery they serve are all controlled by a little-known private partnership that trades in oil, coal, iron ore, and metals: Trafigura Group Pte.

Trafigura is one of the hidden companies that power the world economy, linking suppliers and consumers of raw materials. If the company is known for anything, it was an incident a dozen years ago involving hazardous waste that landed its boss in an African jail and shredded its reputation. These days, having striven to burnish its image, Trafigura is one of the biggest middlemen in the global commodities supply chain. Owned by 600 top employees, most of them based in a discreetly luxurious office block in Geneva, the trading house has been grinding out annual profits of about $1 billion for the past half-decade.

From left: Mike Wainwright, José Larocca, and Jeremy Weir. | This story appears in the June / July 2018 issue of *Bloomberg Markets*.
Photographer: Scanderberg Sauer for Bloomberg Markets

The *Estia*'s voyage, one of 4,500 by Trafigura-chartered tankers this year, signals the company's expanding reach up and down the oil chain. Trafigura is a major owner of a massive nearby refinery complex that produced the fuel delivered via pipeline to the jetty. The refinery was, in turn, the crown jewel in a blockbuster $13 billion acquisition that, at the time, represented the largest foreign direct investment in India's history. The deal, done in conjunction with Russia's state oil company, Rosneft Oil Co., marked Trafigura's coming of age. "Ten years ago, we were sitting outside the door," says Jeremy Weir, the company's chief executive officer, in an interview in Geneva, the de facto capital of the energy trading industry. "Today, we're at the table."

Being at the table is more important than ever. The internet and other advances have made once-proprietary knowledge available to almost anyone with a smartphone. That's forced the biggest traders—such as metals mammoth Glencore Plc, not to mention Trafigura, its closest rival—to bulk up on assets, secure more long-term supply with national oil companies, and streamline trading operations.

For Trafigura at least, it's working. According to bond prospectuses and financial filings, it's paid its employee-shareholders $5.4 billion since 2010 via share buybacks. "The company has made a lot of people wealthy beyond their wildest dreams," says Christopher Cox, a board director at Trafigura and former head of metals.

"Trafigura has become a respected player in its field and—who would have believed it?—the most transparent one in the industry"

Trafigura barely managed to make it to where it is today. Led for more than two decades by its charismatic co-founder, a dapper, hard-driving Frenchman named Claude Dauphin, the company embodied commodities trading of the old-school, take-no-prisoners style. Dauphin learned at the knee of industry godfather Marc Rich, the onetime fugitive from U.S. justice whose eponymous company would morph into Glencore. But Trafigura's swashbuckling culture eventually caught up with Dauphin. In 2006 he spent five months in an Ivory Coast jail after Compagnie Tommy SA, a contractor hired by Trafigura, spilled a load of toxic oil waste. The next year, to secure Dauphin's release, Trafigura shelled out $198 million to the Ivorian government for cleanup costs and compensation to more than 95,000 victims who said they had fallen ill. "It was just stupidity," says Mark Crandall, a former oil trader and one of Trafigura's co-founders. "It's like a Formula One driver who's going too fast and then hits the wall."

The incident became the defining moment in the company's corporate adolescence. Since then–initially under Dauphin, who died in 2015 after a battle with cancer, and now under Weir–Trafigura has fought aggressively to regain and refurbish its standing. If nothing else, the scandal "was a catalyst for change," says Mike Wainwright, Trafigura's chief operating officer, who's been with the company since 1996. "We moved from adolescence to adulthood."

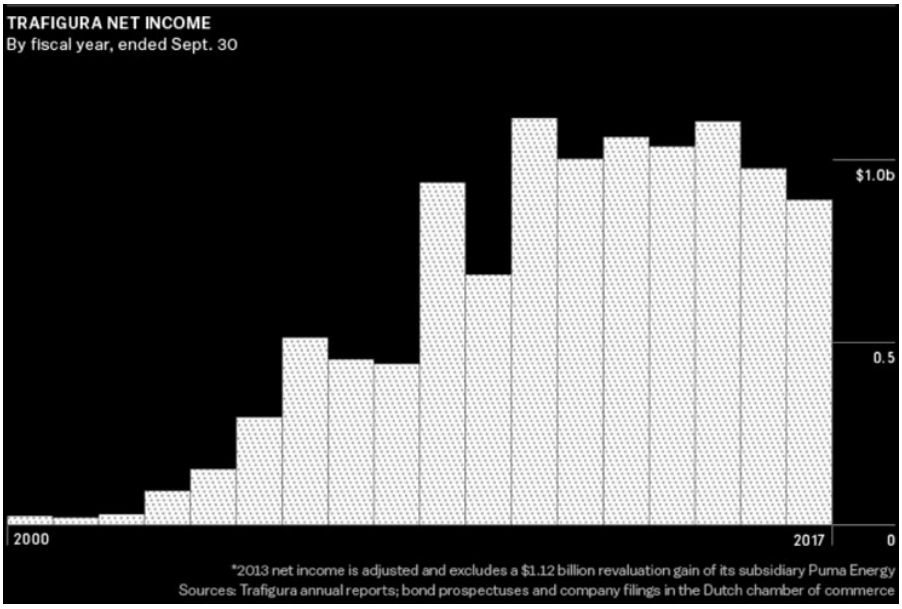
"From maverick and pariah, Trafigura has become a respected player in its field and–who would have believed it?–the most transparent one in the industry," says Jean-François Lambert, who as former global head of commodity and structured trade finance at HSBC dealt extensively with the company. Many of the company's critics are not convinced. "Since its inception, Trafigura has continuously shown an appetite for risky markets," says Oliver Classen of Public Eye, a Swiss nongovernmental organization that favors greater regulation of the commodity

trading industry. “That strategy enabled it to grow in less than two decades into one of the world’s most powerful trading giants.”

While it has battled aggressively to shake off its controversial past, trouble has continued to follow Trafigura. In the past year, Mariano Marcondes Ferraz, a board member who resigned in 2016 after being arrested in Brazil in a bribery and money laundering scandal, was sentenced to 10 years in prison on corruption charges. Trafigura has denied any involvement in the matter saying Ferraz acted on his own and it wasn't involved in the deals.

Commodity companies inhabit a world thick with logistical peril and corrupt political regimes. Oil-trading giant Vitol Group pleaded guilty to grand larceny in 2007 for paying kickbacks to the Iraqi government in connection with the United Nations oil-for-food scandal there. BP Plc and Exxon Mobil paid huge fines and suffered crushing blows to their reputation over oil-spill disasters such as Deepwater Horizon in 2010 and the Exxon Valdez in 1989. Glencore has been beset by a string of scandals, including most recently over its business dealings with Dan Gertler, an Israeli businessman sanctioned by the U.S. in connection with allegedly corrupt deals in the Democratic Republic of Congo.

As part of its corporate face-lift, Trafigura has been among the most aggressive of its peers in scaling back questionable practices and enhancing public disclosure. In 2015 the company temporarily halted a controversial petroleum swaps deal in Nigeria amid allegations of government corruption and increased scrutiny from its lenders. In 2013 it became one of the first large private traders to publish an annual report that disclosed its financial results in detail. In 2014, Trafigura was the first trader to join the Extractive Industries Transparency Initiative, an anticorruption program that requires signatories to disclose certain oil payments to governments.



That Trafigura hasn’t only endured but also thrived says much about the survival instincts of its new leadership. Led by Weir and a management committee recently expanded from three to nine members, it’s grown to become the second-biggest metals trader—behind only Glencore—and the third-biggest independent oil trader, neck and neck with Glencore and behind Vitol. Trafigura, which celebrated its

25th anniversary in April, has never suffered an annual loss. Profits surged from a tiny $3.65 million in 1994, the first year with full annual results, to a record $2.2 billion in 2013, according to documents reviewed by *Bloomberg Markets*. The company's equity has surged, from the $12 million that its six founders put up to start the company in 1993 to more than $6 billion last year.

A relative latecomer to that top table that Weir likes to talk about, the company still pictures itself as the scrappy insurgent. "Being a trading company means you can't get lazy," says Raoul Bajaj, a protégé of Dauphin's and a Trafigura executive since 2006, who's now the head of its rapidly growing India unit. "It's always good to be an underdog."

That's one way of putting it. How Trafigura achieved its success, and how at times it almost lost its way, has been reconstructed by *Bloomberg Markets* through interviews with current and former executives, including the four surviving founders, as well as others in the industry, and through previously unreported financial and legal records.

The Nayara Energy refinery near Vadinar, India, is part-owned by Trafigura.
Photographer: Dhiraj Singh/Bloomberg

It all began with a phone call that not only ended badly but also eventually led to a divorce that would create two commodities giants: Trafigura and Glencore.

It was 1992, and things weren't going well at Marc Rich + Co. U.S. authorities wanted Rich for tax evasion and trading with Iran, still under sanctions following the 1979 hostage crisis. An attempt by Rich's company to manipulate metals prices by cornering the zinc market had gone awry, with the company running up losses of about $170 million. On the personal side of the ledger, Rich was in the middle of an expensive divorce from his wife, Denise.

With his Zug, Switzerland-based empire in trouble, Rich was increasingly running the two-decade-old company as his personal fiefdom, antagonizing his four lieutenants—Dauphin, Willy Strothotte, Manny Weiss, and Daniel Dreyfus. He fired Strothotte after a clash in June 1992. Not long after that, Dauphin, tired of the constant internal battles, resigned to return to his family's scrap metals business in France following his father's death. Within weeks, Weiss and other top executives had gone, too.

Rich, under pressure from his banks, mulled over an exit strategy. Dauphin and others drew up a buyout plan. The various parties tried to reach an agreement whereby Rich would sell his shares over time and the company would be rebranded. Then the mercurial Rich decided he wanted to change the terms. That's when the phone call came. He rang Dauphin to try to renegotiate a couple of details, including keeping his name above the office door. But Dauphin had had enough. "Claude was mightily irritated," Crandall recalls. "He said, 'We are going to be negotiating with Rich until we are dead.' "

Dauphin decided to go his own way. Five others joined him: Danny Posen and Antonio Cometti, who would co-run metals at the new business; oil traders Graham Sharp and Crandall; and Eric de Turckheim, who would become the company's first chief financial officer. Striking out on their own entailed risks. They'd leave behind the comfort of Rich's long-established relationships and trading networks as well as his banking lines, such as they were.

The six executives, most of them in their 30s and 40s at the time, hired a law firm to set up their venture in 1993. They bought a couple of dormant Dutch-registered companies to quick-start the business. By then, Sharp, the oil trader, had secured the company's first deal: buying a cargo of gasoline from the Romanian state-owned petroleum company. Bucharest wanted to sell, but it needed to know to whom. It needed a name. The co-founders were forced to choose quickly between two of the Dutch companies they'd bought: Trafigura and Skydiver. Everyone agreed Skydiver was not an ideal name for a highflying commodities trader. So Trafigura it was.

Although Trafigura began life as a Dutch company that did (and still does) most of its business from Switzerland, in 2015 it fully relocated its registration to Singapore —like Switzerland, a low-tax jurisdiction. The employee-partners own all of Trafigura's shares and control the business through a shell company called Farringford NV, which is registered in the Caribbean tax haven of Curaçao.

The first few years were difficult. Low demand for raw materials and depressed, stable prices meant profitable deals were hard to find. "We underestimated the value of scale, how hard it is to build a business from scratch," Sharp says. What's

more, a competitor was gaining on them. Strothotte, the exec Rich had defenestrated, borrowed the blueprint Dauphin was going to use to buy the company and applied it to what remained of Marc Rich + Co. He christened it Glencore in 1994.

For years, Trafigura treaded water. From 1993 to 2000, its profits averaged only $20 million to $30 million a year. The company's oil business, run out of a tiny office in London's swanky Mayfair neighborhood, was quickly a moneymaker. But the metals operation, occupying a two-room suite in Lucerne, Switzerland, struggled for years to get in the black. That business was more challenging because metals contracts are long-term, requiring patience to build a book, whereas oil contracts and tenders turn over quickly. It was touch and go. "In the first five years," Posen says, "there were moments that we questioned what we were doing."

Then along came a savior from the East. The phenomenal growth of the Chinese economy, especially from 2000 on, drove a relentless demand for almost all commodities. The next eight years were a halcyon period that would later become known as the commodities supercycle. The price of copper shot up from about 61¢ a pound to $3.80; oil prices increased more than tenfold, eventually exceeding $120 a barrel.

At the same time, many of Trafigura's biggest petro-rivals were disappearing. In 2000, France's Total merged with rivals Fina and Elf Aquitaine in a three-way deal. Although Total SA remains a major oil trader today, the merger reduced competition, particularly in Africa, where Elf dominated. Enron, the era-defining U.S. energy trader, filed for bankruptcy after cooking the books and undercutting rivals' profit margins for years. Meanwhile, Big Oil mergers were thinning out the competition. Exxon bought Mobil. Chevron took over Texaco. Neither Exxon nor Chevron possessed the deep-rooted trading culture of the companies they acquired. As a consequence, once-mighty trading arms rapidly withered.

All the commotion benefited a company that as a partnership not beholden to pesky outside shareholders was "thinking long term," de Turckheim says. Trafigura's net income stood at $25 million in 2000. In 2004 it surged to triple digits for the first time, reaching $152 million. By 2006 the company was making a half-billion dollars. It pocketed more than $1 billion for the first time in 2011.

As meteoric as the rise was, it hid just how competitive the world of commodities trading had become. Trading margins are razor-thin today because competition is stiffer and market information more transparent. Even as Trafigura sinks more capital into assets, including refineries such as the one in Vadinar, returns and margins are falling–a problem affecting the whole commodities trading industry. The company's return on equity, a measure of profitability compared with the money that partners have invested, dropped last year below 15 percent, down from an eye-watering 39 percent in 2009, according to calculations based on the company's regulatory filings and bond prospectus. Trafigura earns only 1 percent to 2 percent on its revenue, requiring turnover in excess of $100 billion to

generate profit. That means it has to move huge amounts of commodities. On any given day, it has about 115 vessels on short-term lease plying the seas.

Even so, given market conditions, the prospects of another dramatic boost in profit are slim. The company carries significant debt, much of it to pay for the sheer movement of commodities. And some of its more recent investments, in particular in ports and other infrastructure in Colombia, haven't performed as well as executives hoped they would. All of which is manageable as long as Trafigura can steady the ship and keep it on course, says Chief Financial Officer Christophe Salmon, who joined from French bank BNP Paribas SA, one of the company's key original lenders. "We want a business that can yield a base of $1 billion, some years a bit more, some years a bit less," he says.

A view of the Nayara Energy refinery near Vadinar, India.
Photographer: Dhiraj Singh/Bloomberg

On July 2, 2006, the *Probo Koala*, a double-hulled tanker that Trafigura chartered, arrived in the Port of Amsterdam to change crew, refuel, and discharge oil waste material called "slops" in industry jargon. Then it was due to sail for Paldiski, Estonia, and take on a gasoline cargo to be delivered to Nigeria. But a dispute with a Dutch contractor abruptly halted the discharge. The ship headed to Estonia with all of the waste still on board. After several frustrated attempts to offload the slops, and having delivered the gasoline at port in Lagos, the *Probo Koala* headed to its next stop, Abidjan, the commercial capital of Ivory Coast.

Trafigura says a port agent there chose a recently licensed local operator named Compagnie Tommy to discharge the slops beginning on Aug. 19. According to Trafigura, Tommy –"in flagrant breach of their obligations"–dumped about 139,500 gallons of the toxic waste at "17 or 18 locations" around Abidjan. Within days, residents of Abidjan began complaining of a foul smell. By early September tens of thousands of people were visiting hospitals amid allegations that the slops had caused serious illnesses and fatalities.

Dauphin, always one to confront a problem head-on, didn't hide from the gathering scandal. He put together a team and went straight to Abidjan. Once there, he was swiftly arrested and incarcerated by the Ivory Coast government, and Trafigura's reputation spiraled into a public-relations abyss.

Dauphin hated publicity. And yet only a PR blitz was going to salvage Trafigura's reputation. After the *Probo Koala* disaster and until his death eight years later, he slowly transformed the way Trafigura presented itself to the world. It went from a notoriously secretive company that hid its accounts from the general public to one that suddenly, in 2013, started publishing a glossy annual report disclosing reams of financial details.

Born in 1951 in Houlgate in Normandy, Dauphin went to work for the family scrap-metal business after high school, learning about commodities from the bottom up. Following 10 years or so working with his father, Dauphin went to work in London for Brandeis Goldschmidt, a broker at the London Metal Exchange.

A few years later, Dauphin met Felix Posen (the father of future Trafigura co-founder Danny Posen), who was head of nonferrous metals at Marc Rich + Co. Dauphin landed a job there and moved to metals-rich Bolivia, where he learned Spanish and started a long and profitable love affair with Latin America. He was back in London and head of oil when he broke with Rich. By the time he founded Trafigura, Dauphin was in his 40s. He mixed charm and attention to detail with remarkable energy, keeping to a grueling travel schedule even after his cancer diagnosis.

Six men may have co-founded Trafigura, but nobody embodied the trading house more than Dauphin. His company obituary was close to the mark when it eulogized him as "an inspirational mentor, even a father figure" to others at Trafigura. "Claude was special," says Crandall, one of the co-founders. Not only did Dauphin have the long-term vision to make Trafigura a reality, Crandall says, but he also often acted as a "peacemaker" among the ultra-competitive types who gravitate to this sort of business.

"The big question for Trafigura," Crandall says, "was what happened after Claude: Nobody knew the answer."

The industry was rife with talk that Dauphin's death would ignite civil war at the top of Trafigura and destroy it. Three years later, that's looking like a poor prediction. Weir, who took over as CEO in 2014, has recently consolidated his power, assuming the additional title of executive chairman. Trafigura's head office is a less hierarchical place, even if that leads to what Weir and head of oil José Larocca both jokingly call "animated" discussions.

Executives and traders have a huge incentive to avoid disagreements and preserve a long-term vision because their wealth is linked to the company's fortunes long after they leave or retire. As a rule, though it has the option to defer payment indefinitely, Trafigura buys back the stake of each departing employee in five installments over a four-year period.

What isn't changing is a desire to remain private, eschewing the initial public offering route followed by Glencore, for example. Weir says remaining private is "sacrosanct." Still, Trafigura has toyed with the idea of bringing in an outside investor. In 2015, Rosneft, for example, put forward a proposal to take a 20 percent stake, according to people familiar with the matter. It was rejected.

As its Indian deal with Rosneft suggests, Trafigura is open to investing jointly with others in assets such as ports, fuel stations, and mines. It's already forming a partnership with Mubadala Investment Co., the United Arab Emirates sovereign wealth fund, in a mining project. It co-invests with the Angolan national oil company Sonangol Holdings in Puma Energy Holdings Pte., which owns more than 3,000 fuel stations across Africa, Latin America, and Australia. Most recently it mandated Citigroup Inc. to find co-investors for its Impala unit, which operates ports and warehouses, according to people familiar with the matter.

This is old school: A trader based in Geneva, Singapore, or Houston is typically flanked by a team of operators performing so-called middle-office functions for each physical transaction, whether logging deals, executing hedges, or securing vessels—the day-to-day nuts and bolts of a physical-commodity trading operation. Trafigura began doing things differently in 2012, saving millions of dollars a year. Under the direction of Dauphin and Wainwright, it began relocating middle-office operations outside of its main trading hubs into three lower-cost locations in Mumbai; Shanghai; and Montevideo, Uruguay. Today, deals-desk teams in these cities do more than half of Trafigura's middle-office functions and executions.

Which explains the presence of Pujal Doshi at a modern glass-and-metal building in Mumbai's Bandra Kurla Complex. This is now Trafigura's biggest office, with more than 600 employees. "We started off small, and there was a whole lot of skepticism," says Doshi, one of the team's first hires in Mumbai, a regional deals-desk manager for metals. A forceful 30-year-old, Doshi says her team was particularly busy in April. Aluminum and nickel markets swung wildly after the U.S. sanctioned Russia's United Co. Rusal Plc, one of the world's biggest aluminum producers. "Sometimes when the markets are bad, the traders can be very snappy," she says with a laugh.

The Mumbai move was controversial in some quarters because it broke the physical link between traders and operators that many commodities executives say is critical to avoiding mistakes. But the math is hard to argue with. A middle-office worker in Mumbai with two-and-a-half years' experience earns an average of $23,000 in salary, says Tejinder Hara, a former officer in the Indian army who runs Trafigura's global services unit. In Geneva the same employee would make at least five times as much.

And yet the reorganization of the deals desks, Weir says, has allowed Trafigura to double oil trading volumes in a half-decade to more than 5 million barrels a day while keeping its back- and middle-office costs the same. That's saving money and making journeys such as the Estia's more efficient.

It's all part of a relentless forward momentum as Trafigura seeks to break from the past. "Claude had a certain style," Weir says. "What we have done is enable people to grow and develop. That's important, and that process has modernized the organization."

Hoffman covers commodities in Geneva. Blas covers energy in London.

French Banking Giant Is Looking Like 'the JPMorgan of Europe'

Low-drama BNP Paribas is making a big push abroad as its rivals struggle to rebound.

By **Edward Robinson** and **Fabio Benedetti Valentini**

30 May 2018, 06:00 CEST

From

Jean-Laurent Bonnafé has heard all the reports, all the speculation. For months now, the market has been buzzing with the possibility that his bank, BNP Paribas SA, might take a run at acquiring a beleaguered competitor,Commerzbank AG. And why not? The Frankfurt-based bank has been struggling to find its footing even as France's biggest lender, brimming with

profits, has been pushing hard into Germany's industrial heartland on the hunt for corporate clients.

So is it true?

Bonnafé, a 25-year BNP veteran of stolid technocratic bearing, frowns at the question. It's a rainy spring morning in Paris, and the chief executive officer is sitting in a salon in the bank's palatial headquarters at a table bearing baskets of freshly baked croissants and silver pots of coffee. He shakes his head.

"No, no, no. At this moment, you cannot take on large transactions," Bonnafé says in French-accented English. The reason, he explains, is that BNP Paribas is investing €3 billion ($3.5 billion) to change how it uses technology, deals with customers, and develops new products. Assimilating the digital plumbing of Germany's second-biggest listed bank would set that effort back two to three years. "If you do that, you cannot deliver on the digital transformation," he says. "It's as simple as that."

Bonnafé | This story appears in the June / July 2018 issue of *Bloomberg Markets.*
Photographer: Yann Rabanier for Bloomberg Markets

But what if the price was right, regulators in both countries favored the deal, and other potential suitors were circling Commerzbank? Surely an IT project wouldn't deter a blockbuster merger that would redraw the financial map of Europe. Bonnafé smiles, and with his analytical gaze he looks every part the engineer he trained to be.

"We are not children," he says, sotto voce but firmly.

It's true; the most influential commercial banker in the euro zone isn't the type to be lured by shiny baubles. Ever since he took over as CEO in 2011, Bonnafé has shunned the glory hunting that's long defined global banking. His watchword has been "discipline," and while there have been aberrations—BNP Paribas pleaded guilty to processing transactions for clients in violation of U.S. sanctions on Sudan, Iran, and Cuba and paid $8.9 billion in penalties in 2014—this trait has enabled the lender to steadily take market share from its European competitors and increase its bottom line. Over the past five years through yesterday, BNP shares have outperformed those of most major European lenders, returning 8 percent annually, compared with 3 percent by the Euro Stoxx Banks index.

The story of the past decade in European banking has been one of calamity followed by fitful recovery. The German banks are still reorganizing, the biggest Swiss ones are returning to their roots in wealth management, the British are grappling with Brexit, and Italians are finally digging out of a mountain of bad loans. As the debris is cleared away, it's BNP Paribas, a 196-year-old institution long overlooked as an appendage of the French state, that's emerged as the closest thing the Continent has to a banking champion. With €2.1 trillion in assets, BNP is the euro zone's biggest financial supermarket. It plies millions of customers on five continents with everything from auto loans, checking accounts, and equity derivatives to mergers-and-acquisitions advice.

"It's the JPMorgan of Europe," says Davide Serra, the CEO of Algebris Investments, a company in London that holds BNP shares and bonds. "Bonnafé's approach has been 'Keep it simple, keep it strong, keep it focused,' and that's a contrast with Deutsche Bank and Barclays, which seem to do endless strategic overhauls and new business plans."

BNP is hitting its stride just as France itself is striving to shake off years of malaise and kick-start a more dynamic economy. French corporate leaders, including BNP Chairman Jean Lemierre, have been surprised at how swiftly President Emmanuel Macron pushed through pro-business reforms of the tax code and labor rules that were once considered virtually impossible. Macron is squaring off against powerful transportation unions in a series of work stoppages, and his detractors are wagering that his "En Marche!" agenda will ultimately fizzle out.

Yet Lemierre says the elevation of an outsider who never held elected office shows how fed up the French people are with the status quo. The 40-year-old president has already kindled optimism that France can change and hasn't been shy about taking a turn on the world stage as an unabashed champion of a unified Europe. Asked if the "French moment" has finally arrived, Lemierre, the ever-diplomatic former president of the European Bank for Reconstruction and Development, pauses for a second. "It's a Franco-German moment," he says.

Maybe so, but the trajectories of the two biggest banks in the euro zone's two biggest economies are veering off in opposite directions. For years, Deutsche Bank AG challenged Goldman Sachs Group, Morgan Stanley, and JPMorgan Chase for supremacy in the great game of global finance. But the credit crunch, coupled with Deutsche Bank's swashbuckling culture, saddled it with legal scandals and heavy losses. Its long struggle to recover shows no sign of ending. In May, CEO Christian Sewing said the lender would pull back from the U.S. as part of a sweeping overhaul that could result in thousands of job cuts.

BNP took what turned out to be a more prudent path. It embraced staples: consumer finance, retail banking, corporate lending, custody services, and cash management. Not the sexiest stuff, but the kind of banking that customers need day in, day out. Unlike the relentless drive for action at Deutsche Bank, the BNP trading floor was steeped in caution, much to the chagrin of American and British traders who were eager to bag riches in the markets, according to a former senior executive.

Now this steadfastness is paying off. BNP's pretax income has climbed for three straight years, reaching €11.3 billion in 2017, which bested all competitors in the euro zone except Banco Santander SA, the Spanish retail banking giant. BNP's first-quarter return on equity of 10.2 percent, a measure of how well it deploys its capital, is among the highest of Europe's top 10 banks. And its markets business has been moving in the right direction. In 2017 it leapfrogged Barclays Plc and captured 5 percent of global trading in fixed-income, currencies, and commodities (FICC) business, compared with 4.7 percent in 2016. In equities, BNP outpaced the gains of virtually all major investment banks, including Goldman Sachs, with a 1.2 percent increase in market share.

Even so, the bank faces a raft of challenges that could upset this momentum. It suffered a bruising first quarter, with revenue in its FICC business sliding 31 percent from the same period in 2017, even as some U.S. rivals recorded solid gains. BNP chalked up the poor showing to a lack of demand for trading such securities in Europe, contributing to an 18 percent fall in pretax income for the group as a whole from the same period in 2017. What's more, the retail banking unit in France has been a middling performer in recent years. Pretax income in 2017 came in at almost €1.4 billion, a 31 percent decrease since 2013, and its cost-to-income ratio has increased 7 percentage points, to 73.3 percent.

Some investors grumble that the bank could do a better job at cutting costs. "BNP is a high-quality, risk-managed institution that generates decent returns, but it is perceived as an arm of the French state," says Barrington Pitt Miller, a portfolio manager at Janus Henderson Group Plc, an investment company in London that holds about 3 million of the bank's shares. "There's a sense that at times the balance sheet may not shrink when you may like it to because it has to be there for French interests around the world."

France's sluggish 0.3 percent growth rate in the first quarter is also fanning worries that the European Union's economic recovery might be faltering. A slowdown could in turn prompt the European Central Bank to hold off on raising interest rates, as the Bank of England did on May 10, which would be bad news for lenders eager to charge borrowers more for loans. Algebris's Serra would like to see Bonnafé acquire banks in Italy and increase loans to small and midsize businesses to bolster BNP's Banca Nazionale del Lavoro SpA division there. BNL remains Italy's sixth-largest bank by assets some 12 years after the French bank bought it.

Nonetheless, Bonnafé and his senior management team, who granted *Bloomberg Markets* a series of exclusive interviews, are running something rare in Europe: a sprawling financial emporium that's primed for expansion. "As competitors pull out of markets, BNP can go in and win customers and take market share," says Jason Long, a partner at Harris Associates LP, an investment company in Chicago and one of BNP's top 10 stockholders. "When you look at Deutsche Bank, that's exhibit A."

On an April morning inside BNP's headquarters in central Paris, Bonnafé has every reason to believe the center of gravity in European banking is shifting his way. The 18th century neo-Renaissance mansion exudes the Gallic ambitions of another era. But Bonnafé, who removes his gray suit jacket and drains a glass of orange juice as he settles in for an interview, refrains from describing his business in terms of conquest and triumph. "This is not about becoming a champion. This is not the Olympic Games," he says. "This is banking. Banking is about history and numbers. It's an industry in which you have to survive the cycle. You have to have the ability to go through cycles and deliver a full scope of services in a number of geographies. Anything else is just funny, it's just being 'brilliant.' It's not banking."

A graduate of the Ecole Polytechnique and the Ecole des Mines, two of France's elite training grounds, he started his career as a civil servant in the Ministry of Industry. Bonnafé joined what was then called Banque Nationale de Paris in 1993, the same year the French government privatized the lender. In time he became the bank's go-to executive for integrating acquisitions. In 2000 he managed the union of BNP and the Paris-based investment bank Paribas following a three-way takeover battle with crosstown rival Société Générale SA. (Bonnafé, who turns 57 in July, is quick to correct those who refer to the bank as just BNP: "It's BNP Paribas.")

He was then assigned to head the assimilation of BNL in Rome in 2006. Three years later came Fortis. The Dutch-Belgian lender was crippled by taking part in the €72 billion purchase of Dutch giant ABN Amro Holding NV in 2007, the disastrous deal that also poleaxed the Royal Bank of Scotland Group Plc. After Fortis was bailed out, BNP acquired the bank's businesses in Belgium and Luxembourg, and today the Belgian state remains BNP's No. 1 stockholder with a 7.7 percent stake. Few investors were surprised when Bonnafé succeeded Baudouin Prot as CEO in 2011.

His first order of business was dealing with the new realities of a post-crash world. In August 2007, BNP froze three funds with €1.6 billion in assets that were exposed to the collapsing subprime mortgage market. The move, mirrored by other companies at the time, was a watershed moment in the epochal events that were to follow. BNP, which wasn't as aggressive as rivals such as Citigroup, Deutsche Bank, or UBS, avoided the worst of the fallout.

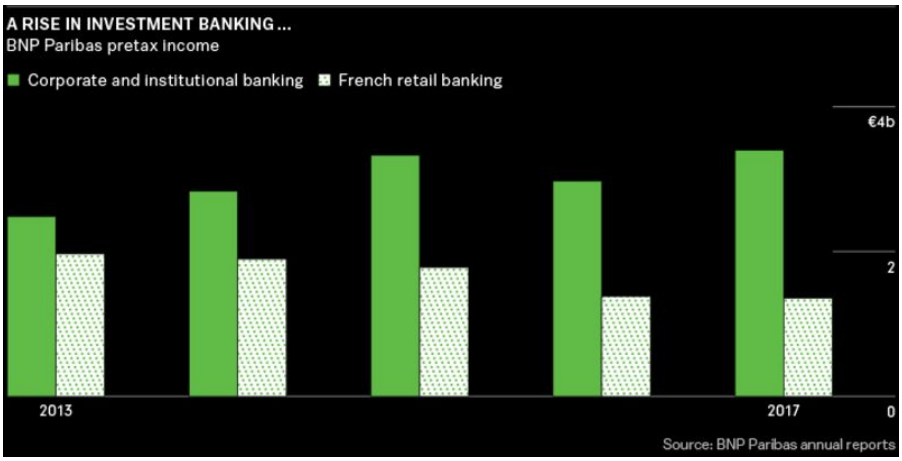
But Bonnafé faced pressing questions as regulators directed lenders to muster more capital to cover lending risk and build up liquidity buffers to absorb shocks. In 2011 the bank started deleveraging its balance sheet. Three years later, Bonnafé unveiled a growth plan rife with assorted revenue and cost-cutting targets. Yet

behind the graphs lay a fundamental question: How will the European economy be financed over the next quarter century?

Companies on the Continent have long relied on bank funding more than capital markets. A 2015 study by the Boston Consulting Group Inc. found that loans to corporations accounted for 55 percent of the euro area's gross domestic product, compared with 15 percent in the U.S. American companies issued bonds at three times the rate of euro zone firms, and the €10 trillion in listed equity capital in Europe was about half that in the U.S.

Bonnafé bet that this imbalance would have to change and that BNP's corporate bank would reap more in fees. In 2014 he tapped Yann Gérardin, a BNP lifer, to head the Corporate & Institutional Banking division and carry out this plan. Gérardin, who set up the bank's equity-derivatives desk, hung a huge photograph on the wall of his office depicting the moss-covered interior of a derelict automaking plant in Michigan. It's still there. "I tell visitors that if we don't change, this will be the future of the bank," he says. He's only half-joking.

Gérardin pursued a bottom-up approach to win new corporate customers, especially capital-hungry manufacturers in Germany's Mittelstand, the stratum of midsize enterprises that forms the nation's economic backbone. The idea was to start by helping companies manage their daily cash transactions and then move them on to more lucrative offerings. "If we are clever enough, next year you'll use us for foreign exchange, and then maybe an interest rate hedging product, and a bond issue after that," Gérardin, 56, says. "So the onboarding of today is the market share gain of tomorrow, asset class by asset class."



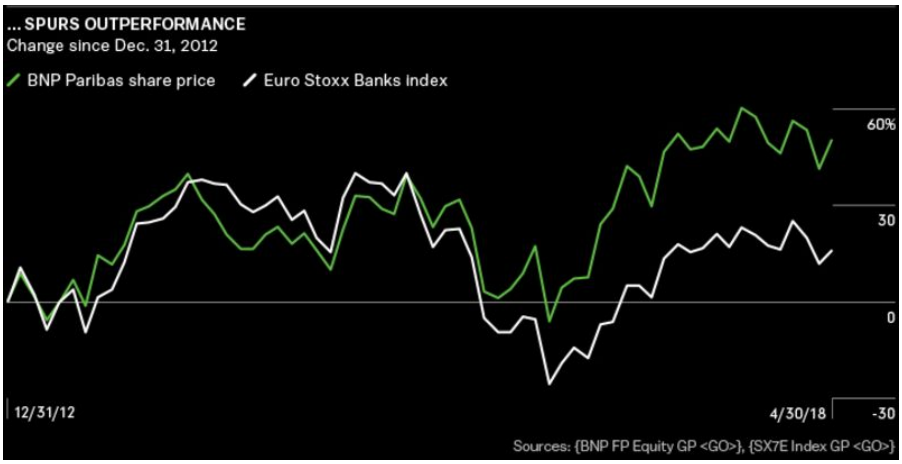
BNP's German headquarters is located on the site of an old freight depot in the shadow of skyscrapers in Frankfurt's financial district. It's here, in a boxy glass structure, that Lutz Diederichs, a 30-year veteran of German commercial banking, is challenging German lenders on their own turf. The abrupt departures of Deutsche Bank CEO John Cryan and his deputy Marcus Schenck in April, both dealmakers with extensive relationships in corporate Germany, would appear to present Diederichs with an opening, though he's careful not to overreach. "Do we necessarily need to be No. 1? No, but for the German Mittelstand you have to be among the top three banks," says the banker, who joined in 2017 after a long tenure at HVB, the Bavarian bank owned by Italy's UniCredit SpA.

Diederichs does have a lot to work with. He runs 13 separate businesses, including wealth management, real estate brokerage, and securities services. He also oversees eight "houses" in Berlin, Stuttgart, Hanover, and other industrial centers. They're not small; the Munich one has more than 100 financial professionals.

By underpricing competitors, Diederichs says, he's willing to compromise profitability to win market share. Last year revenue in Germany jumped 13 percent after increases averaging 8 percent a year from 2012 to 2016, says Diederichs. His goal is to generate €1 billion in sales from corporate clients by 2020. But even if he reaches his target, BNP would still be a second-tier player in Germany; Commerzbank recorded almost €1 billion in revenue from its corporate clients in the first quarter alone. As tempting as it might be to use an acquisition to scale up, Bonnafé is wise to be prudent, say analysts. "If Commerzbank or any other sizable target comes to market, the conditions would have to be very attractive for BNP to justify taking a risk," says Jon Peace, a London-based analyst at Credit Suisse Group AG.

The bank's full-court press may be hard to sustain over the long term in a market where many local players scratch for profits amid subzero interest rates and intense competition. The bank has made a big wager that proximity to potential German clients will pay off. With all its bricks and mortar and multiple businesses, it's going to be tough to control expenses. Diederichs may also find it challenging to raise prices on services after slashing them to capture market share. Not to be outdone, Commerzbank is intensifying its efforts to win new corporate customers, and Deutsche Bank is hiring senior bankers from Morgan Stanley and Goldman Sachs in Frankfurt as it refocuses on its home market.

BNP did bag a watershed deal in March. Along with Perella Weinberg Partners LP in New York, the bank advised E.ON SE, a power supplier based in Essen, Germany, in its €22 billion acquisition of Innogy SE. It was a game changer for the German energy industry, and there were no German banks in the mix, something the nation's CEOs will notice. "Five years ago they never would have thought about BNP Paribas in a deal like that," Diederichs says.



Across the Atlantic, in a suite of offices high above Midtown Manhattan, Jean-Yves Fillion is facing a very different situation: a marketplace dominated by juggernauts such as Goldman Sachs, JPMorgan Chase, and Morgan Stanley. Fillion, CEO of the French bank's U.S. holding company and head of its

corporate and institutional bank in the States, oversees a sizable operation that dates back to the late 1800s. On one side is Bank of the West, a San Francisco-based retail banking operation with $69.7 billion in deposits and 2 million customers in 23 states. On the other is the corporate bank, which is run out of New York and recorded about $2.5 billion in revenue in 2017.

Being in the U.S. is critical to a bank with European multinational clients. Yet Fillion says BNP Paribas has resisted the urge to try to match the U.S. banks product by product. “We have the second-biggest balance sheet in the group outside of France, and we put it to work. But when you compete against the American banks, you’d better be selective,” he says. “If you are not, you might have to do what I have seen other banks do over the last two years: You shrink, you retreat, you lose your relevance. Believe me, I am not casting any stones here.”

Fillion’s operation is content to play to its strengths, and lately that’s meant selling derivatives, long a specialty of the French banks. The recent surge in market volatility has prompted corporate clients to ask for instruments that help them hedge risk. In the fourth quarter the bank had $211 billion in equity-based derivatives and similar contracts, marking a steep rise from 2015, according to records at the U.S. Office of the Comptroller of the Currency. In the equity-derivatives rankings, BNP is running right behind JPMorgan Chase, Goldman Sachs, and Société Générale, according to data from Coalition Development Ltd., a research firm in London. A 19 percent spike in BNP’s equity-derivative and prime-brokerage sales in the first quarter helped the global markets business partly offset the slide in FICC revenue.

BNP’s U.S. team also muscled its way into a market where it had not played a significant role before: collateralized loan and debt obligations. These fee-rich instruments, which are pools of debt sliced into tranches ranked by risk, played a titanic role in exacerbating the subprime mortgage crash of 2007-08. In 2017 the bank originated and distributed more than $9 billion worth of CLOs and CDOs, making it the No. 6 company in the space, Fillion says.

Harris Associates’ Long says he’s keeping a close eye on this part of the business. “What would raise a red flag is if the derivatives book started growing more than the rest of the bank,” he says. Fillion says that isn’t going to happen. “These products became toxic when they were made for pure speculation, vs. solving the true economic need of a client,” the banker says. “That’s why we have remained steady in the derivatives space.”

Ensconced in a plain white office with panoramic views of Parisian rooftops, Sophie Heller is playing a key role in Bonnafé’s €3 billion digital transformation project. She’s chief operating officer of the retail banking and services unit, so the changing needs of customers are very much on her mind. Wielding an iPad loaded with PowerPoint decks, Heller runs through a number of innovations roiling the lending business, including smartphones, machine learning, and cloud computing. She peppers her conversation with references to “optimization,” “net promoter scores,” and “rebalancing channels.”

But the bottom line is pretty simple. “The customer experience has become the

new battlefield," says Heller, the former head of retail banking for the French digital banking business of Dutch lender ING Groep NV. The bank plans to use artificial intelligence programs to anticipate what other services account holders may welcome on their "customer journeys" through its website or mobile app.

When it comes to fintech, though, BNP is lagging rivals such as Santander and Barclays, both of which overhauled their apps and branches years ago. Last July, Bonnafé approved the acquisition of Compte-Nickel, a French digital banking startup, for a reported €200 million, one of the biggest fintech deals in Europe of the year. (The bank declined to confirm the price.) Compte-Nickel lets consumers set up a bank account in about five minutes at thousands of newsstands and tobacco shops.

What sold Bonnafé on the deal wasn't only that Compte-Nickel is reaching a customer base beyond his company's range. It was also how the certainties of his business are becoming, well, less so. "There are ways to do day-to-day banking now without actually being a bank," Bonnafé says. "You can imagine that in 20 years, the bank account may still exist, but its importance may shrink to nothing. You still have wealth, lending, payments."

For Bonnafé, coming to grips with such existential questions is paramount. The man who thinks about banking in terms of surviving the next cycle draws comfort from the decision the bank made long ago to stay intact and to remain a financial supermarket. Now, as Macron asserts France's unifying role in Europe, it's hard not to see an auxiliary role for the country's biggest bank. "If Europe believes in Europe, then it needs a continental bank with a global corporate and institutional banking business," says Pitt Miller of Janus Henderson. "Deutsche Bank may have been that once, but the potential over time is that BNP becomes the bank of Europe."

Bonnafé might balk at such talk, but filling that role is his objective, stated or not. He and his team will do it their way, heads down, laboring for business slowly but surely. If Aesop were writing the fable of European banking, BNP Paribas would definitely not be the hare. Bonnafé doesn't care. "Image and perception are the beginning of the problem in banking," he says. "You have to deliver what your customers want. Anything else is not that important."With that, the CEO rises, puts on his jacket, and walks into the courtyard at the center of BNP's headquarters. He joins Chairman Lemierre and other directors from the board, who're chatting in front of a large white backdrop flanked by studio lights as a photographer prepares to take their portrait for the next annual report. A luncheon will follow. The board members have much to discuss.

Robinson covers finance in London. Benedetti Valentini covers finance in Paris. With Steven Arons, Donal Griffin, and Yalman Onaran

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