INTRODUCTION

BUILDING A BASE FOR STRUCTURED PRODUCTS TEAMS

Wealth managers and investment banks are enjoying a lucrative time for structured products and many are combining divisions to consolidate expertise in the area. Elisa Trovato assesses the landscape in Europe

There is no doubt that derivative-based structured products are currently one of the most lucrative areas for both investment banks and wealth managers.

The creation of a joint team formed by experts of the Barclays Capital structured products team and their colleagues at Barclays Wealth, the recently-formed financial institutions group dedicated to serve banks in the wealth management space, indicates a new step forward in this profitable business. Sharing derivatives know-how and other high-end institutional services between the two divisions, as well as leveraging group contacts, becomes a top priority in this growing financial area, if the aim is to boost profits.

Giles Rothwell, head of investor solutions global business at Barclays Capital (BarCap), who also runs the joint structured products team together with Kevin Lecocq, chief investment officer at Barclays Wealth, sees this new joint venture as a "fantastic opportunity."

The businesses which made up Barclays Wealth Management were run quite independently of each other, until September last year when Bob Diamond, president of Barclays plc, chief executive for the investment banking and investment management businesses comprising Barclays Capital, Barclays Global Investors and now Barclays Wealth, decided to bring them closer together.

"It makes life a lot easier to tap into distribution channels," says Mr Rothwell. "Before we were negotiating with each of the individual channels, which was not as effective as it could have been. There was a lot of replication there. Now we have one team including structurers and internal marketeers who are responsible for it."

Mr Rothwell is keen to make clear that this joint platform is just an additional distribution channel, and in no way is it going to replace their entire sales work. The rapid growth of Mr Rothwell's team, which started off with 30 people in 2003 and now accommodates 100 people, certainly demonstrates the success of the business.

"We have had to work very hard developing propositions for external clients because we did not ever have the traction within our own wealth," he says. "Looking back, that has been an advantage for us because we have had to make sure to get the service levels right with the big external private banks. Now that we have done that, I know we can manage to achieve the same with our internal clients."

As always in these cases, the wealth management division professes independence from the investment bank, in the interest of its clients. The Barclays Wealth business offers an open architecture proposition and this is to give clients choice, says Mr Rothwell.

Another growing distribution channel for Barclays, as it is for other major investment banks, is the e-commerce platform for on-line structured products trading. The recent decision to add commodity-linked structured notes to equities and interest rate products on Barx, Barclays Capital' s e-commerce platform, was backed by a continued positive outlook for this asset class and increasing investors' flows.

> **"GERMANY IS THE COUNTRY WITH THE LARGEST RETAIL DERIVATIVE-BASED STRUCTURED PRODUCTS MARKET IN EUROPE, HAVING REACHED €110BN IN ASSETS"**

The intention is to complete the range with foreign exchange (FX) products, fund derivatives and structured credit, says Mr Rothwell.

The online solution has proved successful with clients. David Wood, director of E-commerce investor solutions says that, once online, 80 per cent of a client's business is done through Barx. Mr Wood does not hide his hopes to see 50 per cent of trades executed online this year.

However, overall volume figures can be misleading because the largest deals still go through over the telephone.

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Mr Rothwell explains that the e-commerce platform has the objective of making "the flow side of the business more efficient." Flow structured products, which are those that clients demand on a daily basis, represent just 25 per cent of the business. "Clients know exactly what they want and ask the firm to price the products up." But in case of pure investment solutions, which also represent a quarter of the business at the international investment bank, "clients will always want to be talking to people." This is also where the innovation is likely to happen.

"We do want to add new tools into the e-commerce platform, so that clients can have various options pricing capabilities themselves, will be able to price up the structures themselves and play around with the underlyings they want to use," says Mr Rothwell. "But we are not there yet." Mr Rothwell envisages that, in the near future this 25 per cent of flow structured products will expand to that grey area which is made of a mixture between pure solution driven business and the flow business. This area represents the remaining 50 per cent of Barclays Capital's structured product business.

In terms of geographical distribution in Europe, Mr Rothwell says that all the different jurisdictions are important, but the types of business are very different. "Italy is by far the more solution-driven type of business that we do," he says. A recent example of this type of business is a thematic product linked to a managed portfolio of property, which the firm has created in collaboration with a large Italian fund manager. Property, in addition to commodities is a great portfolio diversifier, says Mr Rothwell. "We are using two of the largest Spanish wealth managers to distribute it, as a well as a very large Swiss bank. It is unique, just the way it is structured. That is going to sell €1bn relatively quickly," he boasts.

There is a different distribution story is in Germany, where Barclays Capital has built a "sort of retail type market." Here they create products working very closely with distributors who will then sell the products, says Mr Rothwell.

Germany is indeed the market with the largest retail derivative-based structured products market in Europe, having reached €110bn in assets. The enormous growth of over 30 per cent year on year, is also due to regulatory and tax conditions which favours the less-transparent structured products to the detriment of mutual funds.

"The German regulator is the only one in Europe allowing the sale of retail derivatives in bonds," says Rudolf Siebel, managing director at the BVI, the German fund management association. "The German retail derivative market is the largest in Europe, having outstripped the UK, but German structured products are not more sophisticated, not better than those created in other countries." The situation might change in 2009, when all capital gains will be taxed at the same level of 25 per cent, regardless of the length of time investors hold the products for. Levelling out the tax treatment of retail derivatives in bonds and mutual funds will "dampen demand" for structured products, according to Mr Siebel.

But currently German fund managers are going through hard times. Large distributors such as DWS are experiencing difficulties in generating net inflows this year, as reportedly investors are cashing in funds as soon as they get back to the prices of two to three years ago, fearing a possible correction.

A NEW REPLACEMENT

The question arises whether structured products are replacing mutual funds in investors' portfolios. Stefan Armbruster, head of x-markets, the structured products business at Deutsche Bank, believes that the two products are not really mutually exclusive. "I am not convinced that investors are taking money out of mutual funds to invest in certificates," he says. Investors deciding to opt for a structured product have a very quantitative approach, they are informed and know exactly what underlying they want to use. "These two products are sitting next to each other. A lot of people think that structured products are replacing mutual funds but I think it might happen only to a very small extent, if at all." Mr Armbruster identifies in a "very educated group of retail investors" the driving force of the growth of certificates or structured products in Germany. To his comments, the reply of the more cynical Mr Siebel remains that most of the sales of structured products are just the result of a strong push activity by banks.

The lion's share of the structured products business belongs to equity derivatives in most investment houses. At Barclays Capital for example, equity and fund derivatives represent 70 per cent of the total flow. But there is a con-

stant search for satisfying clients' demand for new investment themes.

"Private banks are looking for products that will differentiate themselves, and that can feed into the risk profiles of their clients," says Mr Rothwell, whose team targets predominantly the retail and private banking/wealth management space. "At the moment, there is a lot of interest in sort of green type funds," he says.

Ethical type funds, or products linked to emission trading, wind funds, alternative energy which can be structured are all in great demand. Francois Peningault, head of European private banking coverage at Société Générale brings the perspective of one of the largest players in these investment vehicles.

Responsible for the semi-structured products, which are quicker to build, Mr Peningault observes that "In this area there has been a huge demand for auto-callable products linked to the equity market." The auto-callable products include a large family of products but the common feature is that the product is automatically called at any anniversary date provided that the underlying is above its initial level, he explains. Very simple to understand, investors typically get a coupon of 10 per cent per annum if the equity underlying has performed, and the capital will be protected at maturity assuming no fall up to 25 or 30 per cent on the equity underlying. "Nowadays people are looking for soft protection, and downside equity risk of 30 per cent is accepted by most investors," he says.

Commodity products are also becoming very popular. "We have been astonished by the demand for commodity products," says Mr Peningault. "Three or four years ago, commodities were a new investment for the portfolio, so investors usually went for some capital protection feature," he says. "Right now investors are seeking the same type of commodity exposure that they have on equities," he adds

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AN ITALIAN TRADITION

Demand for commodity-equity linked structured products has reached Italy too. Fideuram, one of the largest Italian banks with a powerful network of 5,000 advisers or 'promotori', has just started distributing its first three structured products to its high-net-worth clients. One of the products is linked to the price trend of four commodities.

"We want to offer our clients certificates that respond to two main requirements," says Francesco Minelli, marketing director at the Italian bank. "We want to give our clients exposure to current trends, such as commodities, emerging markets or China, but we also want to guarantee a certain capital protection," he says. The second requirement, around which the bank is marketing the two other products, aims to cover investors' need to receive a coupon, which can be fixed or variable.

The bank set up a dedicated platform "Fideuram Stars" in September 2006 with aggressive plans of launching new structured products every two months, this year.

The idea is to employ external investment banks to create the structure and then sell it to its clients.

The model seems to work. The first certificate launched last year linked to the performance of European and Japanese markets collected €82m, according to the bank. "It has been such a great success that we have decided to offer a second version of it," says Mr Minelli. All the certificates launched by the bank have that auto-callable functionality, so that when they reach a particular target return, they automatically give the money back to the investor "like a take-profit."

"When investors are earning a lot, they would like to invest further, but we force them in some way them to do the opposite thing when they reach a challenging objective. That is automatically monetised," says Mr Minelli.

Clearly showing that the unbridled passion that Italians have for the national sport pervades even financial activities, this functionality has been called 'golden goal'.

"It draws the comparison with the football match, when one scores the golden goal during the extra time, the game finishes and the team who has scored wins.

"The important thing for us is really to speak the people's language," he adds.

One could object that not everybody, certainly not all women, know what a golden goal is. But Mr Minelli says that in Italy "investors wear the trousers."

"The financial decision-maker is, in the large majority of cases, a man," he concludes.