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European regulators target 'due cost'

The announcement follows the publication of the annual statistical report on the cost and performance of EU retail investment products which found that retail investors pay 40% more than institutional investors.

The European Securities and Markets Authority (Esma) and the European Insurance and Occupational Pensions Authority (Eiopa) have elevated the cost of investment products as 'a challenge for the whole market' and a driver of 'some of our supervisory work now'.

According to Tim Shakesby, principal expert on financial innovation at Eiopa, the findings of the report 'indicate we should start a conversation about the due cost' of investment products.

'This is something we are now looking more squarely,' he said during a webinar to present the results of the annual statistical report. 'We're aware of some out-layers with products in the market where you could not see this could ever make sense to the customer.'

In the third iteration of the report, the regulators were able to access a lot more information as well as to leverage natural language processing techniques to extract information from Priips KIDs.

However, there is a lack of information to enable the regulators to do an analysis across all member states, according to Tania de Renzis, senior economist, risk analysis and economics department at Esma.

'Cost is a major consideration for investors [and it] remains variable for retail structured products in terms of countries, payoff types, etc,' she said. 'With RSPs the problem is the lack of transparency and data compared to Ucits.'

In terms of simulated returns and costs the report found that once costs are considered, the simulated returns for several RSPs were below zero.

'This illustrates the benefit of mandating, as done in the Priips KID Delegated Regulation, that performance scenario information provided to investors in the KID be made available net of costs,' said de Renzi.

The report is based on a limited data sample of 16,288 KIDs issued between 01 January 2018 - when the requirement to produce KIDs began to apply, and 31 December 2019 - the data cut-off point for the report. In addition, structured insurance products are not analysed separately but included in the Eiopa's unit-link product section.

Eusipa - Esma report: not a true depiction of the market

The European structured products trade body points at the flaws on the recent report released by Esma on cost and performance of structured products.

As the European regulators move to target the 'due cost' of investment products and point at the lack of transparency and data in the structured products market, SRP spoke with Thomas Wulf, secretary general at the European Structured Investments Products Association (Eusipa) to find out the industry's position in relation to the findings of the report.

"We appreciate the effort of showing what is happening in the market at a European level, but it is clearly not enough," said Wulf. "To have a full picture of the risk exposure of the retail investor population to structured products, you need to have the insurance product landscape within the retail structured products analysis."

Currently, the Esma report is split following the European Securities and Markets Authority (Esma) and European Insurance and Occupational Pensions Authority (Eiopa) mandates. In the part covered by Eiopa, structured (insurance) products are not singled out but embedded in the unit-linked product section, while the scope of analysed products and the used methodologies differ between the two reports, as well.

"This prevents us from being able to compare both reports and have a full overview of the structured products market," said Wulf.

"Using a broad key information document [KID] database and then running the (entry) cost indication against a moderate performance scenario can only deliver indicative values but does not depict the true market picture in terms of how a product performed at end of maturity," said Wulf.

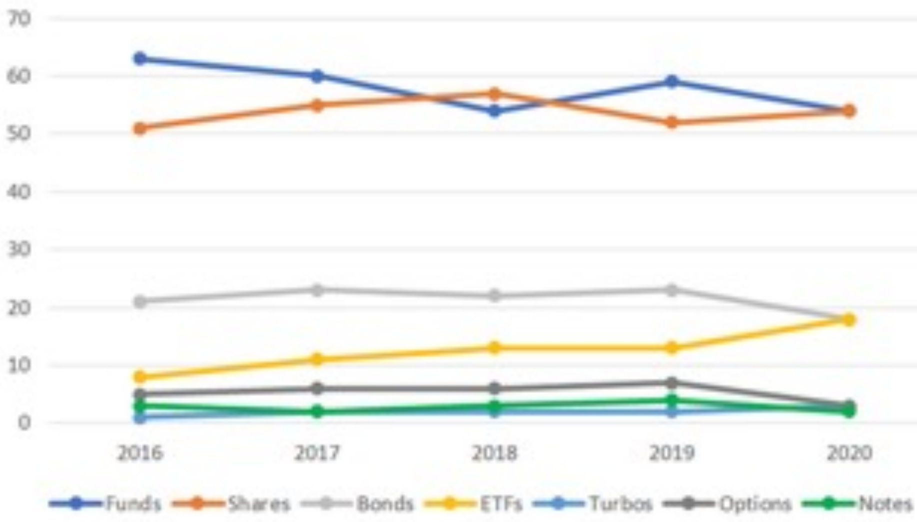
Dutch appetite for turbos and notes remains low, AFM

Investors in the Netherlands prefer investment funds and equities over ETFs, leverage products and notes, according to a study conducted on behalf of the regulator.

The number of Dutch investors increased by 160,000 to 1.6 million in 2020, according to the Consumer Monitor Investing, which is published annually by the Netherlands Authority for the Financial Markets (AFM). One in five households now invests – an increase of 11% compared to 2019 – and building up wealth is their main motivation.

For two-thirds of new investors, the need for higher returns was the main reason to invest and more than half felt they were helped by the ease with which an investment account can be opened. Forty percent of the respondents indicated they had wanted to invest for some time but were looking for a suitable time to get in, which was presented by corona crisis because of the good entry point and the availability of time and money.

Evolution investment products in the Netherlands 2016-2020 (%)



Source: AFM Consumer Monitor Investing, Ipsos 2020

"The stock market is in a dip because of Covid-19, which to me seemed an excellent time to start investing," one respondent told the survey.

Fifty-four percent of respondents had invested in funds during 2020, a decrease from 59% the previous year. Equities, also at 54%, increased by two percent while index trackers and exchange-traded funds (ETFs) were up by six percent compared to 2019.

Although there was an increased interest in leverage products (turbos), which, at three percent were slightly up from last year, demand remained low. The same applied to options and other derivatives (three percent) and structured notes (two percent), which registered a decrease of four and two percent on last year, respectively.

Experienced investors more often own shares and investment funds than starting investors (59% vs. 44% and 58% vs. 48%, respectively). New investors often invest in index investment funds, index trackers and ETF's (34%) and the difference with experienced investors (14%) for this product type is the greatest of all investment products.

For six out of 10 starting investors, independent investing (execution only) is the most important way of investing. This is an increase of 12% compared to 2019 and was driven by the emergence of user-friendly investment apps and the increasing familiarity of online services.

Young people in particular start investing with more than half (51%) of new investors between 18 and 34 years old. In the group of experienced investors, that share is only 14%. The starting investor is not only younger, but also increasingly highly educated compared to the experienced investor (78% versus 56%) and woman (48% versus 24%). New investors also have smaller assets: 62% have less than €5,000 in freely investable assets compared to 16% with experienced investors.

Sustainability is vast becoming an important aspect in the portfolio of many investors. Seven in ten (68%) investors who invest through an advisor or asset manager want this to be taken into account. This is slightly lower for independent investors. For both groups, novice investors attach more value to sustainability.

The study was conducted on behalf of the AFM by Ipsos, a market research and consulting firm, which sent out 1,200 surveys between 20-26 November 2020. Of these, 601 questionnaires were fully completed.

Vontobel adds partner and issuer on Deritrade

The Swiss bank will support the issuance of products on a white-labelling basis via its multi-issuer platform.

Vontobel and Banque Cantonale Vaudoise (BCV) have entered into a strategic partnership for the white labelling of structured products.

The strategic cooperation covers the entire structured products value chain with BCV acting as issuer, and Vontobel taking responsibility for structuring, pricing, documentation, issuance, and lifecycle management.

The partnership with BCV means gaining 'another renowned issuer, which has a strong market position in the French-speaking region of Switzerland,' said Markus Pfister (pictured), head of structured solutions & treasury at Vontobel.

'This cooperation will help us to further grow Deritrade's market share in French-speaking Switzerland and enhance its positioning,' he said.

With effect from today (11 May), structured products issued by BCV will be available on Vontobel's Deritrade expanding the platform's issuer pool which includes Vontobel, J.P. Morgan, Deutsche Bank, Société Générale, UBS, BNP Paribas, Basler Kantonalbank and Zürcher Kantonalbank.

'The white-labelling partnership with Vontobel allows us to offer a fully digitalized offering across the entire lifecycle of a structured product,' said Eric Vauthey, head of trading at BCV. 'This pioneering cooperation is a perfect fit for our strategic focus [as] numerous Swiss banks and external asset managers can gain fully-automated access to our structured products.'

Vontobel reported earlier this year that more than 100 banks, 460 external asset managers (EAMs) and 5,500 users transact structured products via Deritrade.

Swiss investment manager acquires LinkedTrade platform

The Swiss group is seeking to expand its investment solutions offering and technology edge as it enters structured products market.

Swiss asset management and trading services provider Valeur Group has acquired LinkedTrade Technologies, the SaaS structured products multi-dealer platform, to strengthen its 'positioning and enhance its investment solutions offerings'.

London-based fintech LinkedTrade launched in 2018 to connect the buy- and sell-side offers of end-to-end automation for the design, pricing, trading and risk monitoring of structured products.

The partnership with Valeur is part of the firm's plan to accelerate its digital developments and expand its footprint and growth outside Europe.

As a Saas provider, the firm has offered its software to private banks and brokers for the last four years, "helping a number of brokers to automate their entire structured products activities across all regions and broker-dealers to transition their business from voice brokerage to a fully digitalised set-up".

"One of the main requests from our clients is to have a broad and fast electronic connectivity with all major investment banks and issuers backed by a robust and secured infrastructure," LinkedTrade's CEO, Nicolas Gaumont-Prat told SRP, adding that although other services such as life-cycle management are also critical, the platform's clients "are looking for a solution that allows them to save time, reduce operational costs and produce an exhaustive audit of all the communication with the manufacturers".

"Once the journey from pre-trade to post-trade is fully automated, the structured products activities scale up significantly at a very marginal cost. We are connected to one of the biggest pools of issuers and are now serving distributors in several European markets, including France, United Kingdom, Switzerland and Luxembourg."

Europe remains Linkedtrade's core market as it is where the growth is coming from - but the firm has plans to expand its reach and build its presence on other continents.

Deutsche targets Belgian investors with green bond on article 9 SFDR fund

The bank offers Belgian investors access to article 9 SFDR fund with the added incentive of 100% capital protection.

Deutsche Bank Brussels is distributing Green Note Fund Opportunity NOK 2026 in Belgium. The six-year securities are fully capital-protected and participate 100% in the performance of NN (L) Patrimonial Balanced European Sustainable P Cap EUR, an open-ended fund that invests in a portfolio of eurozone fixed income instruments, including green bonds, and stocks from companies that pursue policies of sustainable development whilst observing ESG principles.

The notes are part of Deutsche Bank's green bond framework, and the proceeds will be used for the (re)financing of green projects in the fields of energy efficiency, renewable energy and green commercial real estate. It is not the first time the bank has launched a green structured bond. Previously, it has distributed green or social bonds from BNP Paribas, Société Générale, and Natixis.

According to Pierre-Yves Druenne, head of CMP & Insurance, Deutsche Bank International Private Bank (IPB) in Brussels, sustainable investing is a theme that is becoming increasingly important for the bank.

"We feel a real demand from investors for ESG and green solutions," said Druenne. "This product combines using the proceeds via a green program with performance linked to an impact generating underlying. It is the kind of product which we will distribute more and more in the future."

The underlying fund is actively managed and aims to deliver a return that beats the performance of its benchmarks MSCI Europe Index and Bloomberg Barclays Euro Aggregate over a period of five years.

"We chose it for two main reasons: our analysts had a positive view on the fund, and also because of article 9 SFDR," said Druenne, referring to the fact that sustainable investing is the specific objective of the fund, as defined in article 9 of the EU legislation for sustainable finance disclosures regulation (SFDR).

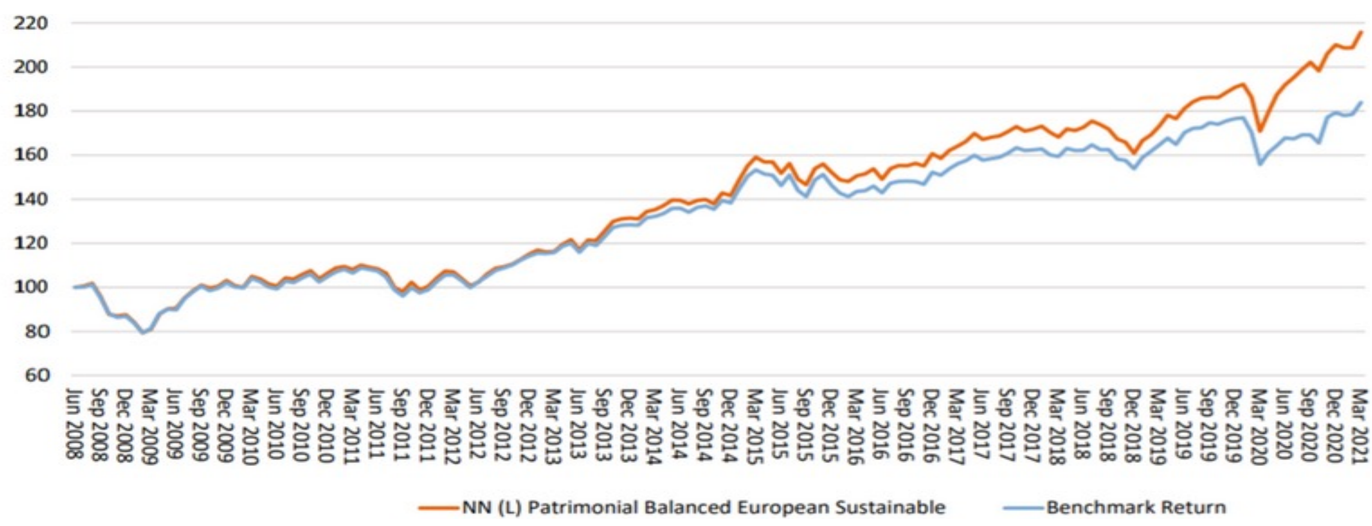
NN (L) Patrimonial Balanced European Sustainable P Cap EUR is part of Deutsche's gamma of 1,800 investment funds (from 30 different providers). However, via the note, investors can fully participate in the fund, with the additional bonus of 100% capital protection at maturity.

"Absolutely, but please note that the product is denominated in Norwegian kroner, which implies an FX risk in case the client converts to euro to invest," Druenne warned.

Deutsche Bank is the second most active distributor in Belgium (behind Belfius), with a 27% share of the market in 2021 to date.

So far this year, the bank has launched 16 products worth an estimated €170m.

Evolution NN (L) Patrimonial Balanced European Sustainable P Cap EUR



Source: NN Investment Partners, 31 March 2021

Garantum's maturities deliver

The Swedish structured products specialist's returns are boosted by a combination of macro research and quantitative structuring capabilities.

Since its first publicly issued structured product, Garantum has seen more than 1,300 products mature with an average return of almost 19%, and an annual return of as much as 7.8%. Of all products that have matured, more than three-quarters of investments have given a positive return.

As a specialist in structured products, Garantum put a lot of emphasis on combining macro research with quantitative structuring capabilities, according to Mats Eriksson, structurer, at Garantum.

"Even though we have a rather extensive offering, we always strive to offer investments that suits our current macro view," said Eriksson, adding that the company's chief economist Christer Tallbom emphasizes on the economic environment, economic growth, stock market valuations, and interest rates.

On the structuring side, Garantum is looking at the market conditions in terms of volatility, rates, dividend expectations, credit spreads and asset correlations.

"By twisting and turning different structures based on these combined conditions, we try to find quantitative values to repackage into our products so that our clients can see and understand them.

"For example, a client might look at expected return through a fixed coupon for taking market exposure on underlying stocks that fits our macro view. Our structuring desk on the other hand looks at dividend expectations, volatility and correlations," Eriksson said.

SRP dove into its data and had a look at the performances of some of the Swedish provider's most popular product types between 2016 and 2020. This is what we found.

CREDIT-LINKED NOTES

Garantum saw 88 credit-linked notes (CLNs) mature between 1 January 2016 and 31 December 2020, according to SRP data.

The structures, which were issued on the paper of Nordea (35 products), Handelsbanken (23), Société Générale (21), Danske Bank (eight) and BNP Paribas (one), were linked to a large variety of underlyings, including Markit iTraxx Crossover (48 products), Markit CDX North America High Yield (14), Johnson & Johnson, Kimberly-Clark (11 each) and Coca Cola (nine).

They paid an average annualised return of 5.63%. In 2017, the highest annualised returns were achieved: 8.16% from 14 maturities.

The best-performing CLN in the period, Kredithybrid Sverige Top Pick nr 1569, was issued via Nordea and linked to the credit risk of five Swedish companies (Electrolux, Skanska, ABB, Svenska Cellulosa and Tele2) and iTraxx Crossover S19. It sold SEK10.7m (US$1.3m) at inception and when it matured in July 2018 it returned 320.12%, or 25.9% pa.

SPRINTERS

Some 76 sprinter certificates matured in the period, and their average annualised return was 5.54%. The products, which typically offer a high degree of participation in the underlying, but no capital protection, were issued via 14 different manufacturers, of which Goldman Sachs (15 products), ING Bank (14) and Commerzbank (11) were the most prolific.

2016 was the best year for sprinters, with an average annualised return of 8.3% from 12 maturing products, while 2020 was the only year that registered a negative return (-0.9% from nine products).

The best performing sprinter, just like the best performing CLN, matured in 2018. Sprinter Stora Enso 1,5 år nr 2951 was issued via Danske Bank and participated 135% in the share of Stora Enso, a manufacturer of pulp, paper and other forest products. It sold SEK3.76m and returned 189.10% after 1.56-years (50.48% pa).

CAPITAL PROTECTED PRODUCTS

Two hundred and eighty-three (partially) capital-protected products that sold a combined SEK6.6 billion (an average of SEK23.3m per product) matured between 2016-2020. Their average annualised return was 3.95%.

The structures were issued via 23 different counterparties, of which UBS was the most prolific (56 products), followed by Goldman Sachs (48) and Bank of China/ Credit Suisse (36).

With an average annualised return of 6.25% (from 45 products), 2017 was the best year for capital protected maturities, however, the best performing product matured in 2016. Aktieobligation USA Export nr 58 Tillväxt, which was issued in collaboration with Deutsche Bank, returned 242.28% after five-years (19.18% pa). The product sold SEK30.46m during its subscription period and participated 170% in a basket comprising 10 US companies (Coca-Cola, IBM, Johnson & Johnson, Kraft Foods, Procter & Gamble, Pfizer, McDonalds, Yum! Brands, Heinz, Colgate-Palmolive), subject to 12 months backend averaging.

AUTOCALLS

Nearly 230 products worth a combined SEK6.7 billion (an average of SEK23.3m per product) had their autocall triggered during the period. The average annualised return of these structures was just over two percent. In 2017, returns, at 10.6% (from 58 products), reached their highest levels, but negative values were seen in 2019 (-0.17% from 40 products) and 2020 (-7.86% from 44 products).

UBS (186 products), Société Générale (134) followed at some distance by ING Bank (33), were the main issuers.

HSBC adds AI powered multi-asset index to US offering

In another first for the industry, the UK bank is offering a new proprietary index in the US structured products market.

HSBC has introduced the AiMAX, an AI powered rules-based multi asset index which is the first of its kind to use artificial intelligence as a means of constructing a diversified growth portfolio. The launch follows the arrival of the firm's initial risk-controlled product which entered the market in 2020. The AI Powered US Equity Index (AiPEX) was developed by investment technology platform EquBot.

According to Dave Odenath, HSBC's head of quantitative investment solutions for the Americas, AiMAX is intended to be a 'go anywhere' strategy with the flexibility to position a portfolio for growth in different types of potential market environments that industry players may encounter over the coming decades.

"We've tried to be at the forefront of what we think is a revolutionary technology in our industry, that being artificial intelligence and machine learning. We are first to market, both with our equity index AiPEX last year, and now with our multi asset index, AiMAX," said Odenath.

AiPEX offers 100% equity exposure and was a pioneer in the incorporation of AI with crediting strategies within fixed index annuities. The excess return index and uses IBM Watson's AI capabilities to turn data into investment insight. It consists of approximately 250 publicly-traded companies in the US, selected monthly and is based on a three-step equity selection process.

"I think we expect this type of technology to continue to be a big part of the class offering that we have at HSBC going forward," said Odenath. "We are taking the technology and the investment process that we started with AiPEX and we are now allowing the AI to be able to choose not only US stocks but a variety of different asset classes."

There are different potential values that custom indices can deliver to structured product investors such as pricing efficiency and liquidity. HSBC is currently aiming to develop strategies that respond to increased demand for yield-based products - a trend which ties in with the bank's focus on the US side to deliver differentiated products in the structured products market.

"Pricing efficiency is of top priority for investors as rates continue to stay low, especially in the structured product space," said Odenath. "There's been a lot of focus lately on potential rising rate environments, and how that impacts strategies that do have a reliance on duration or have historically had a reliance on duration."

S&P DJI debuts crypto index offering, upgrades ESG suite

The index provider joins the cryptocurrency bandwagon as demand for exposure to digital assets continues to grow. S&P Dow Jones Indices (S&P DJI) has debuted the S&P Digital Market Indices, a new series of digital asset benchmarks measuring the performance of recognised open cryptocurrency exchanges.

The new index family consist of the S&P Bitcoin index, Ethereum Index and the Cryptocurrency MegaCap Index which tracks the performance of both bitcoin and ethereum. An additional expansion including other coins and broader-based indices such as large cap and broad market benchmarks will be introduced later this year.

The indices enlist the aid of crypto software and data provider Lukka to determine the eligibility universe and pricing of individual constituents. According to Peter Roffman, managing director and global head of innovation and strategy at S&P Dow Jones Indices, a challenge the firm addressed during the index construction process was sourcing an institutional-grade pricing source.

"Bringing any new asset class to market and applying S&P DJI's quality standards is an in-depth process so it did take some time," said Roffman. "In terms of cryptocurrencies, we would emphasise that cryptocurrency markets are different from traditional financial markets in many ways – there is not a single market or consolidated tape for reporting data."

Given the liquidity and historic performance characteristics, it is likely that a wide variety of structured product strategies could be deployed for investors. However, this is highly dependent on individual risk tolerances, as well as market views.

Axio enters defined outcome space

Axio Financial has announced the acquisition of structured unit investment trusts provider m+ funds to widen the firm's suite of defined outcome and alternative offerings.

Axio has established itself in the US structured products market through its customisation and distribution platform, which the firm expanded over the past year to include a suite of new products for advisors and their clients.

The platform now offers structured notes, market-Linked CDs, m+ defined outcome funds (structured UITs), and interval funds, while several new products such as an ETF and insurance wrapper will be rolled out over the course of 2021.

According to Marc Paley (pictured), chief executive officer at Axio, the firm was looking for ways to work with m+ funds on the distribution side.

"We knew m+ funds for a long period of time and we were very impressed with their products. Over time, it became apparent that the best course of action was to acquire m+funds. This way we can properly integrate it into our business," said Paley.

Last year, Axio distributed a total of US$5.1 billion across all its sales channels with Paley forecasting a figure of US$9 billion in distributions at the end of 2021.

"This is a space we know very well, and we would like to provide our clients with different solutions in the defined outcome space. We want to take a more solutions-based approach to the business and become a one-stop shop for financial advisors in defined outcome," said Paley.

Axio will continue to focus on yield products with various degrees of equity risk as they are very popular among clients and is of top priority to them.

The firm's market-linked CD activity has also jumped in recent months, because of the gradual increase in interest rates, allowing Axio to bring three market-linked CDs to the industry in April.

While market is slowly opening, there is still a heavy dependency on the trajectory of interest rates while inflation could very well be a precursor to higher rates.

"If the markets continue to trend upwards, I think you'll see more of what we've had the first four months and our expectation is that we will see some more volatility, going forward," said Paley.

Brazil's XP adds new themes via custom plays

Brazilian investment management company XP has launched multiple notes linked to differing baskets in a bid to diversify its product suite. The firm has seen significant growth from indices in commodities from multiple structures on commodities tied to diversified indices as well as gold which accounts for 15% of its distribution over the past few months.

In March 2021, the firm deployed a COE (certificate of structured operations) linked to a customized commodity global exchange-traded fund (ETF) Solactive XP Indice de Commodities VT 15% (SOLXPCOM). The underlying is the firm's second customised index after the launch of the Solactive XP Indice de Acoes Americanas de Tecnologia VT 19% index (SOLXPTEC) in 2020. In addition to an influx of commodity interest among investors, comes the rising phenomenon of environmental, social, governance (ESG) which continues to gain momentum on the back of the Covid pandemic as well as deforestation of the Amazon in Brazil.

XP has identified technology as a strong driver of demand and forecasts that clients will begin to look for technology related sister themes, such as electric vehicles. One of the firm's most recently launched notes was the autocall COE tied to the FANG (Facebook, Apple, Netflix, and Google) basket with a five-year maturity.

The bank's most popular COE was tied to SPDR S&P 500 ETF Trust featuring a straddle with floor payoff and indicates a strong interest in US stock baskets among Brazilian investors. XP has also launched a call spread structured product related Cannabis and tracks the performance of the ETFMG Alternative Harvest ETF and a geared call COE linked to the J. P. Morgan MSCI Future Education index.

Mexico: BBVA sees jump in ESG interest, debuts 5G play

The Spanish bank's Mexican arm has noted a significant uptick in structured products that are exclusively tied to the ESG theme over the past year and bleeding into the first quarter of 2021.

ESG as a theme is definitively gaining ground among Mexican equity investors but with a great variety in the level of awareness and knowledge. For the most advanced investors, ESG criteria are already being directly used in their investment strategies.

According to Pablo Parra head of global structured solutions, Mexico at BBVA, ESG themes have been considered for many years by Mexican corporates but have been limited to the publication of dedicated sustainability reports to analyse their performance in each of the three ESG criteria.

"Even though the level of commitment remains variable among listed entities, we have witnessed a quantum leap in the past couple of years with major Mexican corporates creating both specific ESG committees, and the contemplation of ESG criteria in investment decisions or for management retributions," he said.

During 2020 and 2021, BBVA Bancomer saw many launches of ETFs, investment funds and indices with an exclusive ESG angle. Similarly, warrants have been a vehicle to implement and deliver ESG investment strategies to investors and the bank expects more in the coming months.

As it continues to develop its quantitative investment strategies (QIS) offering , the Spanish bank has also developed a series of ESG indices, with five being distributed globally. In April 2021, it launched a new 5G index Solactive BBVA Next Generation Networks Index.

SHORTER TERMS

Structured product issuance in the first quarter was strong despite increasing apprehension among Mexican investors amid upcoming elections that will decide the majority in Congress.

"Investors have opted to maintain high liquidity by decreasing the term of the notes or by buying products with a high cancel probability in the short term, but otherwise have shown an increased interest versus the first quarter of 2020, which was hit by the Coronavirus pandemic," said Parra.

SRP data shows that BBVA was the second most prolific issuer group in the Mexican structured products market during Q1 21 with 377 products worth MXN16.9 billion (US$839m), compared with 398 products valued at MXN21.8 billion in Q1 20.

BBVA's product issuance gradually grew during 2020 reaching 506 products in Q3 20 worth MXN19.2 billion, and then fell to 431 (MXN17 billion) in the final quarter of 2020.

Monex structured product volumes buckle

The Mexican financial group has seen its sales of structured products in the retail market more than halved in the first quarter of 2021. Monex sold MXN56 billion (US$2.8 billion) in structured products during the first quarter of 2021, a steep decline from its volume of MXN116 billion in the same period of 2020, SRP data shows.

Monex's product issuance has remained steady over the past year decreasing to 803 (MXN34 billion) in the second quarter of 2020 from 988 in Q1 20. This number recovered during the following quarter to total 1,096 products while sales were boosted to value MXN46 billion. Issuance fell once again to 960 at the end of the final quarter of 2020 and picked up in Q1 21 to total 973.

"We are seeing clients looking for short term products (7 and 14 days) that can improve their portfolio performance," Ricardo Guido, director at Monex, told SRP, adding that directional bets in FX via step up note as well as capital protected products in FX such as wedding cakes were on demand during the first quarter.

Monex remains the most dominant structured products issuer in the Mexican market, followed by BBVA Bancomer with 377 products worth MXN16.9 billion, Citi with an issuance of 57 products valued at MXN5.2 billion, Santander with 53 products worth MXN1.9 billion, and Scotiabank with 17 products worth MXN1.2 billion.

Of the structured products issued by Monex in Q1 21, two structured bond wrappers are live with strike dates of 29 January 2021, and 17 March 2021, respectively. Both products are dual currency notes with short-term maturities and are tied to the USD/MXN currency pair.

Barclays deploys prop index in the US as carbon comes out of age

The UK bank is seeking to leverage its index capabilities as ESG becomes one of the most prominent themes in the US structured products market.

Barclays has recorded an increase in investor interest regarding its Barclays iPath Series B Carbon ETN since the fourth quarter of 2020 amid rising popularity of environmental, social governance (ESG) strategies in the US structured product market.

The exchange-traded note (ETN) was re-launched in 2019 and tracks the Barclays Global Carbon II Index, which holds EU Emissions Allowance futures.

According to Barclays director Gavin Filmore, the bank developed its first carbon credit index over a decade ago. At the time, the concept of carbon credit schemes was in its infancy though there was the expectation that carbon credit markets would develop globally across multiple regions.

“The reality for the public market is that it is very hard to create a product that has a tangible impact. In the private markets, you’ll see private equity funds that are created around specific impact but to do that in the public markets is nearly impossible,” said Filmore.

From a carbon credit market perspective, one can very quickly make a strong case for it having impact as the only reason carbon credits exist, are for the sole purpose of regulators influencing carbon emissions, said Filmore.

In the last decade, the market has witnessed many carbon markets that were developed but never had the liquidity that would be necessary to support relevant products.

“What we did about two or three years ago is we relaunched the index to speak to that reality, so instead of trying to have an index that was going to participate in many markets, we created a simpler index which only allocates to the most liquid market which is the EU Emissions Trading System,” he said.

> “
> **It is very hard to create a product that has a tangible impact**

Filmore recognises ESG as one of the most prominent themes while the groundwork behind it has been brewing in the background for several years.

This trend has maintained its dominance in Europe which saw significant product development and asset flow over the course of the last five years. However, the US market is quickly catching up. Prior to 2020, ESG momentum in the US structured products market was relatively slow and although there were discussions about the ESG space, product development and asset flow were less than encouraging.

“It seems like 2020 was the watershed moment in the sense of it no longer being a debate if ESG was really going to be a theme for the US,” said Filmore. “I think that’s completely shifted and it’s here to stay.”

FIAs dwindle despite interest rate climb

Fixed indexed annuity sales dropped by 15% in the first quarter to $13.7 billion amid an overall boost in fixed annuity sales of 4% in Q1 21 to US$31 billion.

The sale of fixed indexed annuities (FIA) during the first quarter of 2021 has decreased by US$400m from the fourth quarter of 2020, according to data recorded by the Secure Retirement Institute (SRI).

Despite the first quarter decline in FIA sales, the steadily improving interest rate environment is anticipated to bolster FIA sales throughout the year. SRI is forecasting FIA sales to increase by between eight and 17% in 2021.

“When you look at the FIA space, it’s quite interesting because like similar product lines, it bottomed out in the second quarter of last year due to the pandemic,” said annuities director Todd Giesing. “Then we saw figures slowly creeping up and they grew by US$1.2 billion in the third quarter and just US$900m in the fourth quarter.”

The fall in FIA sales could point to various factors that involve the carriers being conservative with their pricing because of ongoing uncertainty, as well as the existence of alternative solutions such as registered index-linked annuities (Rila), which are doing currently dominating the marketplace.

“The uptick of Rila sales mean that these products are more attractive to investors that are willing to take out a little bit of risk for higher upside potential in this space,” said Giesing.

Rila sales continue to experience significant growth in the first quarter 2021, Rila sales totalled US$9.2 billion, 89% higher than the first quarter 2020.

HSBC targets SFOs in Asia with bespoke offering

The UK bank has launched an institutional service targeting single family offices (SFOs) in Hong Kong SAR and Singapore to provide complex solutions including structured products developed by the investment bank.

The new set-up supports prime services and private deals across FX, rates, credit and equities, which would usually be available only to institutional clients, by giving SFOs access to the combined capabilities of HSBC global banking markets and HSBC private banking.

"We expect this interaction to be more complex in nature, with larger trade sizes, focused towards portfolio optimisation, hedging and solutions oriented rather than outright optionality for directional bets seen across the flow structured product traditionally traded," Antony Shaw (pictured), global head of emerging markets and wealth sales at HSBC markets and securities services, told SRP.

"The street tends to trade the bulk of structured products with more generic payoffs. We see the SFOs being far more bespoke, requiring different and deeper skill sets which will require much closer interaction between sales, structuring and trading to deliver the types of complex solutions these SFOs require."

"We are aiming to compliment the private banking offering to ensure our clients have the full access to HSBC's capabilities across both the private bank and investment bank," said Shaw.

In addition, with the new service SFOs will be able to explore innovative ways to access opportunities around sustainable finance and ESG investing offered by HSBC investment bank.

"This is going to be a new trend although there's been talks about SFO platforms at investment banking for over a decade. It's a good thing for us," said a senior source at a Hong Kong SAR-based SFO, noting that it will take time for the office to know well the new service in light of the legacy partnership it has built with other private banks, such as UBS Global Family Office.

MSCI rolls out China thematic suite

The US index provider is in talks with private banks and broker-dealers to licence its suite of 20 China thematic indices customised for structured products.

The new China catalogue was launched on 18 December to capitalise on 'the long-term structural trends' in the country. MSCI hosted a series of webinars for its clients to introduce the indexes and discuss the key megatrends driving China's economy.

"Our MSCI China thematic indexes have been very well received and there has been a real appetite for structured products on China thematic, particularly the thematic at the crossroad of technology and green economy," Stéphane Mattatia, global head of derivatives licensing and thematic indexes at MSCI, told SRP.

The rules-based offerings span across transformative technologies, society and lifestyle as well as environment and resources in China, which MSCI identifies as megatrends 'expected to significantly impact the economies and societies around the world in the future'.

"Unlike traditional, backward-looking investment approaches that focus on past winners, thematic investing reflects a future world that may be very different from the past," said Mattatia.

The new China investable market index (IMI) thematic indices are equally categorised as A onshore shares or all shares by selected universe, the latter of which include A-shares and B-shares listed in China, H-shares, Red-chips and P-chips listed in Hong Kong SAR and foreign listings.

The 10 themes featured on the series include aging society opportunities, digital economy, disruptive technology, efficient energy, future mobility, autonomous technology & industrial innovation, millennials, next generation internet innovation, robotics and smart cities.

Recently the index provider has bolstered its on-shelf products offering China exposure, especially after the outbreak of Covid-19 with the addition of the MSCI China Tech 100 Index (USD), which went live on 3 December as MSCI's first China thematic index and was 'recently' licensed to a Singaporean private bank and used in warrants.

SK watchdog implements new guidelines as mis-selling debacle reverberates

The Financial Services Commission (FSC) has implemented a series of regulatory measures in South Korea following the mis-selling incident in August 2019. We recap the major regulatory moves as they gradually take into effect.

The dominant products in the South Korean market are equity-linked securities (ELS), equity-linked bonds (ELB), derivative-linked securities (DLS) and derivative-linked bonds (DLB), which are traded over-the-counter - together had a balance of KRW82.8 trillion (US$74.9 billion) at the end of March 2021. Equity-linked warrants (DLW) and equity-traded notes (ETN) listed on the Korea Exchange account for a small market share.

ELS and ELB track equity indices, stocks, ETFs and ETNs while DLS/DLB are tied to credit performance, ETF, private equity funds, interest rates or commodities. ELB and DLB offer full principal protection while ELS and DLS don't.

LATEST REGULATORY CHANGES

Effective 10 May, a cooling-off period of at least two business days must be given to all investors of 'highly complex investment products'. The investment agreement will become valid only when the investors reaffirm their initial decision after the cooling-off period. The criterion for 'elderly investors' is lowered to the age of 65 or above, from 70 or above previously.

Banks play a significant role in distributing non-listed structured products in South Korea

Financial institutions (FIs) are required to record their sales process when such products to elderly investors - the recording and deliberation system will be put into use on 10 August.

FOCUS ON 'HIGHLY COMPLEX PRODUCTS'

The products are defined as non-listed 'derivatives products, derivative linked securities and derivative-linked funds (trust, discretionary)' that can lead to principal loss higher than 20%, according to the finalised measures the SFC announced on 12 December 2019. Specifically, they apply to ELS and DLS with no more than 80% of capital protection.

These criteria went into effect on 2 February 2021 along with other major regulations including the increased minimum investment threshold in private equity funds from KRW100m to KRW300m for retail investors. In addition, if a fund's profit and loss structure is equivalent to that of its underlying asset, the fund must be sold as a public offering fund. It aims to prevent FIs from avoiding stringent regulation on public offerings by choosing private placements.

LIMITS ON BANKS

Under the new rules, banks can only sell publicly-issued equity-linked trusts (ELT) that track any of the five major market indices – Kospi200, S&P 500, Eurostoxx 50, HSCEI and Nikkei 225 – when it comes to highly complex investment products. Moreover, their ELT balance amount shall not exceed the level seen at the end of November 2019.

Banks play a significant role in distributing non-listed structured products in South Korea in the form of ELT, derivative-linked trusts (DLT), equity-linked funds (ELF) and derivative-linked funds (DLF). Approximately 40% of the total balance of ELS/ELB/DLS/DLB, or KRW49.8 trillion, was incorporated through banks as at the end of June 2019. ELT and DLT together contributed KRW42.8 trillion out of it, according to data from the FSC.

For ELS, retail investors made up about 98%, or KRW40.4 trillion at March-end 2020. About 82% of all ELS issuance, or 88% of ELS issued to retail investors was distributed through banks, said the FSC.

The limit on banks impacted the non-principal protected note market even before it officially went into effect on 2 May 2021. The SFC initially proposed to ban on such products at banks on 17 November 2019 when it first released a series of measures to 'strengthen investor protection' in wake of the mis-selling incident.

The measures have also introduced internal guidelines for reform at banks and securities houses with a focus on sales practice. For example, financial institutions are required to keep relevant documents and data for 10 years and immediately submit such documents upon investors request. The classification of investors will be renewed at a regular basis within one to two years instead of one to three years.

Mis-selling financial products are subject to punitive fines up to 50% of unfair gains, fines of up to KRW30m and shift of the burden of proof.

PRODUCT GOVERNANCE AND RISK MANAGEMENT

On 30 July 2020, the SFC released plans to 'improve rules on structured products' with an aim to enhance securities firm' capability of dealing with market volatility and to encourage reduction of issuance sizes as well as diversified investment for hedge assets.

The move came as the low interest rates environment made retail structured products attractive, which may lead to burdens on foreign exchange market and short-term money markets due to large volume of issuance.

As reported, securities houses are required to conduct stress tests reflecting more extreme case scenarios.

JPM expands warrant range in Thailand amid rising offshore demand

J.P. Morgan is now the only issuer in the country offering derivative warrants tracking all three key US stock indices including the S&P 500 and the Nasdaq 100 after adding new warrants linked to the Dow Jones Industrial Average (DJIA).

The warrants, which are linked to the DJIA series ID E-mini Dow ($5) futures listed on the Chicago Mercantile Exchange with one put and one call available, began trading on the Stock Exchange of Thailand (SET) today (28 May). J.P. Morgan Securities (Thailand) is the issuer and J.P. Morgan Securities plc acts as the market maker.

"As the US indices linked warrants are the only real time traded leverage product currently available in the Thai market, it helps to expand the product universe for Thai Warrants investors, providing portfolio diversification with underlying products other than those linked to the Thai stock index which focus more on energy names," Cedric Cheung (pictured), head of listed structured products sales for Asia at J.P. Morgan, told SRP.

With each issued 120,000,000 shares, the call warrant is priced at THB1/unit while the put is at THB1.52/unit. Both will expire on 22 September and be exercised in European style. They have a strike level of 39,500 and 29,500 with multipliers (USD/point) of 0.00008 and 0.000007, respectively.

The call closed down 36% to THB0.64 while the put down 23.3% to THB1.17 on the first trading day. In the meantime, four warrants on the same underlying were listed on the Hong Kong Stock Exchange today issued by J.P. Morgan Structured Products B.V. They have an implied volatility from 27.5% to 34% and a gearing from 11.64x to 24.56x.

In the Thai market, the US bank has introduced 29 S&P 500 warrants with a cumulative turnover of around US$23m since their debut on 28 September 2020 – representing the highest among all warrants on US indices, according to Cheung.

The bank's warrants on the Nasdaq 100 have recorded an cumulative turnover of US$14m through 14 warrants since their first listing on 21 January.

"Thai investors are still watching out for new opportunities to diversify their portfolio, especially investing in overseas markets with different economic systems and investment environment," he said. "Therefore, the foreign indices-linked warrants that offer different exposure on a diversity of business sectors tend to attract investors' attention."

The traction of offshore exposure is also seen in the non-listed structured product market in Thailand as major issuers step up their non-principal protected offerings linked to offshore equity following the outbreak of Covid-19, which feature household US tech names and blue chips in Hong Kong SAR.

In the listing market, Macquarie Securities (Thailand) is another active player offering offshore exposure. The Australian bank remains the sole issuer of HSTECH warrants and launched HSI warrants in Thailand last August - marking the first warrant issued over a foreign index on SET. Subsequently J.P. Morgan marketed HSI warrants, but currently has no live product.

HSI is now the second most active index underlying for warrants at a distance following SET 50 in Thailand. SET 50 warrants accounted for 50.2% of the market through its monthly trading value of THB71.6m in April despite a low issuance, according to SET data. The total daily trading value of warrants reached THB7.9 billion, making up nine percent of the whole SET market in April.

> "Thai investors are looking for new opportunities to diversify their portfolio

Thai regulator lowers net-worth requirement for SP investors

The country's regulator is seeking to reclassify investors, which will enable non-retail investors with reduced net worth to access non-principal-protected notes

The Securities and Exchange Commission (SEC) is seeking to redefine its investor classification based on their affordable loss, investment knowledge and experience, which will comprise professional investors (PI), qualified investors (QI), affluent investors (AI) and retail investors.

If the rules are passed, the minimum net-asset required for investors eligible for non-principal-protected notes, which offer less than 80% of capital protection by definition, will drop to THB30m (US$960,507) from THB50m while retail investors continue to be limited to principal-protected notes.

The current investor segments consist of institutional investors, high-net-worth (HNW) as well as ultra-high-net-worth (UHNW) investors and retail investors according to their affordable loss. And only institutional and HNW/UHNW investors are eligible for non-principal-protected structured product investments.

'This will expand the pool of potential qualified investors and offer more opportunities for them to be able to invest in more variety of assets to increase their wealth,' stated the SEC in a consultation report.

'Also, this would increase the capital available for the fundraising tools responding to underserved sectors, which tend to be riskier, while still maintaining the appropriate investor protections.'

Under the proposal, retail investors will be limited to invest in products that meet the regulator's quality, information and plain (QIP) requirements, including stocks, real estate investment trusts (REITs), general debentures with credit ratings, perpetual bonds, investment-grade bonds, structured notes with capital protection, futures and derivative warrants.

In the meantime, structured notes with no capital protection – to be classified as 'complex or high-risk' products - will be available to the other groups with AI being required to have net worth above THB30m , which is lower than the THB50m and THB70m currently set for HNW and UHNW investors, respectively.

Additionally, products linked to exotic assets will be defined as 'super risky,' only accessible by PI and QI - they include the Basel III tier I instruments that are non-investment grade, insurance capital bond, distressed bond fund and private equity trust.

Individuals with an investment planner (IP) or investment consultant (IC) licence can only be classified as PI for products for which they are licensed. Holders of IP and IC licences or individuals with any certified investment licences such as CFA or CISA can also qualify as AI and QI if they meet the financial criteria.

'Apart from investor segmentation, the proposed amendments also aim to ensure investor protection for investments in certain high-risk assets either by scoping the potential impacts within the narrow group of investors or by imposing the investment limit per investor,' stated the Thai regulator.

The amendments are expected to come into force on any financial product regulated by the SEC except cryptocurrency.

SK DLB drop, DLS rebound in Q1

Derivative-linked bonds (DLB) have remained more popular than derivative-linked securities (DLS) in the first quarter of 2021 in South Korea despite a drop in sales.

Sales of DLB fell 15.5% to KRW3.8 trillion in Q1 21 quarter-on-quarter (QoQ) as issuance decreased 26.2% to 223. In the meantime, the same number of DLS was issued, totalling KRW1.5 trillion, up 40.3% QoQ, according to data from the Korea Securities Depository (KSD).

Together this was a 11.3% and 4.7% drop of issuance and sales volume, respectively, QoQ. On a yearly basis, Q1 21 saw issuance dip 42.9% but maintain a stable volume. Public and private offerings accounted for 10.7% and 89.3%, respectively, of volume.

In addition, the total outstanding balance of DLB and DLS was stable at KRW27 trillion as at the end of March, compared with a quarter ago.

By asset class, interest rates kept a safe lead by linking to DLB and DLS worth KRW3.1 trillion representing a market of 58.8%, down 16.2% QoQ. Credit used in products valued at KRW1.4 trillion, saw a 33.4% rebound from its yearly low a quarter ago.

Indices resurfaced as underlying assets in Q1 21 linking to two products at KRW 500m after disappearing in the third quarter of 2020. The volume of fund/ETF/ETN-linked products remains stable at KRW310m compared to a quarter ago. They were not seen in Q2 and Q3 20.

The repayment amount of DLS and DLB amounted to KRW5.6 trillion in Q1 21, down 19.9% QoQ or 37.4% YoY. Approximately 58.1% of this was redeemed early, higher than the 52% seen a quarter ago.

Crédit Agricole: demand for Libor notes lingers in Japan

The French bank has expedited the transition of its Libor-linked offering with a series of SOFR-based trades.

Following the execution of several SOFR swap trades in Asia, SRP spoke to Lilian Darbon, head of trading for Apac at Crédit Agricole CIB, about the bank's progress on the Libor transition in Asian markets and the lasting demand for Libor-linked structured notes in Japan.

In a move to capitalise on the accelerated transition to risk-free rates (RFRs) in Asia, Crédit Agricole closed the first USD/CNH cross-currency swap (CCS) against secured overnight financing rate (SOFR) cleared on the HKEX with Bank of Communications in China, on 17 May. The trade, which had a notional of US$20 million, is a one-year CNH CCS fixed against USD SOFR at 2.43%.

Two days later, the French bank and the Bank of China executed a SOFR vs Tokyo Overnight Average Rate (TONA) swap transaction, in a first for the Chinese market.

"The liquidity of SOFR has improved drastically in Asian time since the switch at the central clearing counterparties (CCPs) of LCH and CME last October, even if it's not comparable to the level seen in US time," Darbon told SRP.

Despite concerns about the lack of long-term liquidity of SOFR curve, Darbon believes the benchmark will be quoted outright in the near future, rather than against Libor as it often is at present.

On 5 March, the International Swaps and Derivatives Association (Isda) announced the fixing dates for the spread adjustment for all Libor rates - 30 June 2023 for USD Libor with all tenors except one week or two months.

"Interestingly we've seen large American banks arbitraging this market in US time [since the announcement]. If there is any divergence in Asia, the market will quickly come back to its fair value," said Darbon.

In addition, Isda data shows that the RFR adoption indicator rose to 10.1% in April from 8.7% in March – it reached a peak of 11.6% in October 2020 and dropped to 8.3% a month later before gradually picking up again.

JAPAN

"[The data] indicates that the conversion from JPY Libor to TONA moves much slower than in some of the other major currencies and there's some stagnation," said Darbon, adding that the slowdown may be attributed to the reduced capacity triggered by Covid-19.

On 26 March, the Japan Securities Clearing Corporation (JSCC) announced plans to convert all interest rate swap cleared contracts whose floating rate option is JPY Libor to those referencing TONA - overnight indexed swap (OIS) - by the year-end.

The ratio of cleared notional that TONA represents at JSCC came in 7.5% in April, which highlighted a slow conversion, according to Darbon.

"There's a clear need for a sharp increase of the use of TONA in the following months as the deadline of 2021-end is looming and the amount of liabilities and assets referencing in JPY Libor is huge in Japan – US$24 trillion," he said.

The progress is also reflected in the Japanese structured product market where the French bank continues to receive requests for JPY Libor-linked notes as it aims to offload the overall Libor exposure.

"[The clients] are not ready for the switch yet," he said. "We'll go through a process involving the top management to verify that no alternative is available to the clients, and that the documentation for the JPY Libor products integrate the proper fallbacks of the benchmark."

At Crédit Agricole, most JPY Libor-linked structured notes are deployed as callable inverse floaters with a tenor of 20 to 30 years.

"Since early 2021, the majority of the contracts have switched to Tokyo Interbank Offered Rate [Tibor] but there is still a not negligible proportion of clients who insist on using JPY Libor," said Darbon.

"The expanded use of TONA is likely to take place at a later stage because clients are not ready to handle the compounded rate, which can be problematic. Domestic Tibor is more likely to remain favoured for interest rate-linked structured products," he said, adding that some clients are also interested in Tokyo Term Risk Free Rate (TOFR) as an underlying asset. "We expect to see a significantly rising liquidity of TONA in the coming months."

On the US dollar side, the investment bank has done 'larger trades' in the US to meet stronger demand for SOFR-linked notes, mainly from private banks. It has not yet traded any SOFR-linked structured product in Asia.

Besides the lagging seen in the Japanese market, Darbon noted the rising concern about a split between several RFRs in the Asian market, leading to less liquidity and unclear market views.

"Since January, the effort made by the banking industry on the transition has increased drastically," he said.

HK SAR family offices: ELNs, FCNs preferred as they provide ample liquidity

Family offices in Hong Kong SAR are increasingly using structured products as a risk management tool for portfolios given the ample liquidity in the equity market.

Following the latest high-profit antitrust penalty imposed on Chinese tech giants, Tencent and Alibaba, the Family Offices Association Hong Kong organised a webinar to discuss the needs and challenges of its members.

The news about the two household names is too important for Hong Kong investors to overlook as a majority of his family clients who are interested in equity have positions in the stocks, according to Derek Cheung, head of EAM department at Topaz Financial Group.

"The portfolio is not well balanced if we don't have any position on Alibaba. If we have too much on this stock, we might be exposed to too much political risk," said Cheung.

Edmond Lau, senior investment director of Far East Consortium International (FECI), a Hong Kong SAR-based listed real estate firm, said the single family office has for a long time been accumulating positions on Tencent and Alibaba as favourite representatives of the tech sector. Between half and one-third of the overall equity exposure is accessed through structured products.

"We use structures like ELNs [equity-linked notes] and FCNs [fixed coupon notes], which enable us to customise our target limit on the upside and downside. That's one way we express our view that I think will pretty much fit in the scenario," said Lau.

In the derivatives space, the consortium founded by late Hong Kong entrepreneur Deacon Chiu often uses interest rate swaps for its bond portfolio, which accounts for the second largest proportion of the total portfolio after real assets.

"We [traded] that in 2018 and later again in 2020. The interest rate can't be zero forever. There will be a time to dance," said Lau. "But at the same time you can not stop investing in bonds as that's the only way to hedge your interest rate risk."

According to Lau, the family office's portfolio allocations are generally conservative with a focus on investment-grade bonds, which help manage the tail risk - one of the most significant risks in the market along with liquidity risk.

"When the market is liquid, we are able to sell more real assets and have more cash flows to deploy into other asset class," he said.

The real estate company sets an investment limit for each asset class, including real assets, bonds, equity, FX and rates, commodities and funds, on a quarterly basis - sometimes monthly depending on the rate environment, real estate market and overall economy.

At Topaz Financial Group, structured products are mainly used for yield enhancement against cash. As an example, the multi-family office may split US$100 half for Tencent cash equity and half for ELNs or FCNs linked to Tencent shares.

"Investors may prefer buying the stocks directly when the price goes up, but we will try to balance because there's no sure win," said Cheung, adding that Tesla has always been in the multi-family office's portfolio.

He also highlighted an index designed for institutional investors tracking a benchmark fixed income allocation without disclosing the index name. It was linked to a bespoke structured note, which proved that structured notes can be act as an 'efficient coupon-paying product' in the portfolio.

"Instead of having the coupon being invested back to the bonds, clients get a certain percentage of coupon on a quarterly basis. That's definitely for mid-to-long term position in clients' portfolios," Cheung said, adding that the index was designed for institutional investors and is lower cost than mutual funds.

"With a benchmark allocation, you can capture the market and have that diversification," said Cheung. "It's not a bad alternative, particularly for clients who want to have more passive allocation."

He noted that the uncertainty about the antitrust news about the Chinese tech giants are already out and digested by the market in some way which could make structured products more attractive as the volatility and liquidity rise.

VOLATILITY

"I would advise to look beyond the short-term windows and try to pick cyclical winners," said Edward Liu (right), head of investment services of Goldhorse Capital Management. "I think in the US, Hong Kong SAR and China, there will be sector rotation this year. It can be value. It can be growth. It's a dynamic time right now because [the economy] is rotating and there's ample liquidity."

Structured products can help mitigate the risk in portfolios by forecasting price volatility, according to Liu.

"We've started seeing some cases of Covid-19 bounce back [in Hong Kong SAR] over the last couple of days, this reminds us that is not over yet," he said. "There's over liquidity you have to hedge, which could lead to a lack of yield."

View from the top: the focus on risk management over yield paid off in 2020

The events of March 2020 sent the financial markets into a downward spiral, recording significant drawdowns and levels of volatility not witnessed for decades.

> **There are certain aspects of structured products that make them difficult to deal with in a private banking environment**

Some open ended structured funds and funds of structured products took a hit as the buffer in the bonus and discount certificates in their portfolio became too small, and they could not be sold in the secondary market, others claimed that even at the March lows the relevant indices were roughly 20% above the levels where capital would be risked.

The £81.5m (US$113.4m) AUM VT Protean Capital ELDeR Fund took advantage of its focus on risk management which became particularly evident during the Covid-19 crisis, when the fund exhibited the lowest drawdown of any structured product fund available in the UK market.

We have a three-year track record and the fund has performed as expected - Eduardo Montero

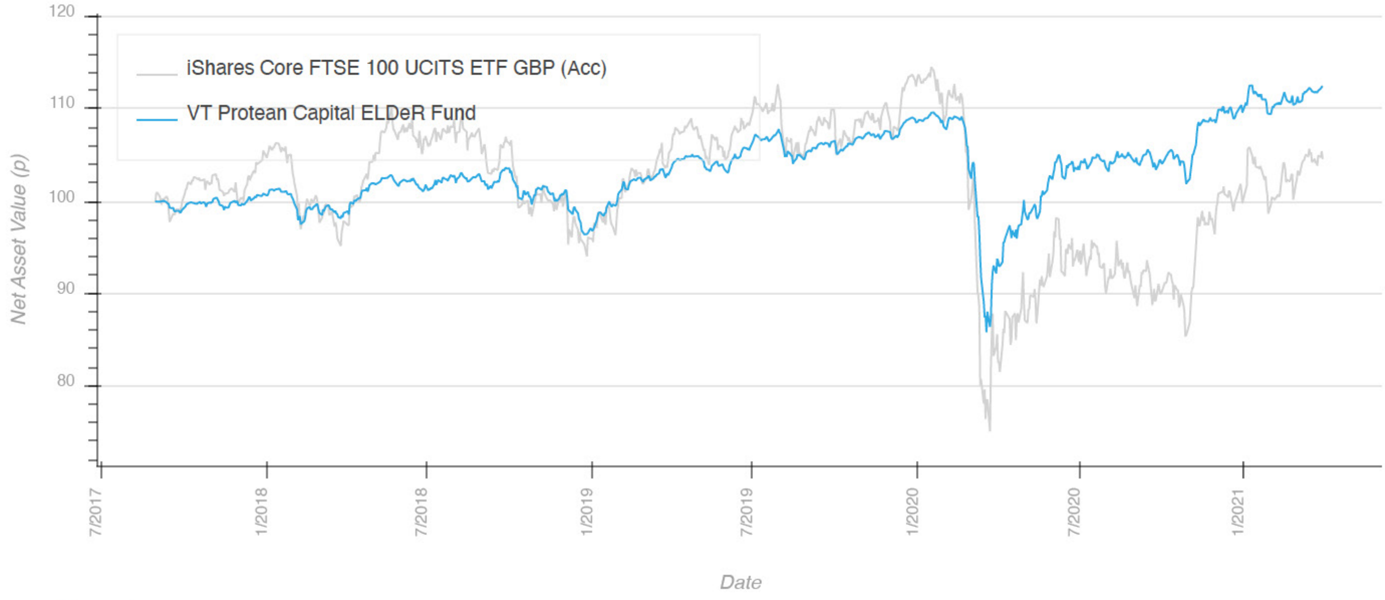
"March 2020 played in favour of our delta target – the NAV of the fund fell roughly half of what the market did," says Eduardo Montero, partner and senior team member at Protean Capital.

The fund can invest in structured products issued by global financial institutions, transferable securities, financial derivative instruments, debt instruments and government bonds to provide consistent income in a wide range of market conditions, with the potential for growth over the long term. It has Ucits status requiring the highest standard of credit diversification and spreads risk across different types of assets, industries, geographies and product types.

Historically, the ELDeR fund has generated four percent pa for the existing A Share Class (available to institutional clients) and expects to achieve the same for the retail share class; the I Share Class with 1-2% capital growth over the long term.

"We have a strong background in structured products structuring, trading, and sales and that has transpired into the philosophy of the fund," says Montero. "We all know about the benefits of structured products but there

Fund NAV (30/08/2017 - 31/03/2021)



Source: Bloomberg

are certain aspects that make them difficult to deal with in a private banking environment – multiple issuances makes it difficult for the private banker to rebalance portfolios, secondary market can be challenging etc."

The main selling point of a structured product fund is that it can help investors to resolve that via the NAV, and the ability to buy and sell instruments as required.

"If you look at how investment banks sell their structured products, how the trader hedges the different Greek sensitivities (delta, vega, rho), we replicate the characteristics of the payout of those products with bonds, futures and options," Montero says. "We decompose the sources of return of structured products (delta/equity, rho/credit, volatility) and deploy vanilla instruments such as bonds, futures and options in an efficient way to achieve our target return."

DERIVATIVES V AUTOCALLABLES

The use of derivatives over autocallables in a fund has two advantages, according to Montero. On the one hand, the cost - the more products you have from an investment bank the more difficult to deal with the bid offers you get on those products (barriers, cancelations…). The commissions can also increase making the total cost of the product higher.

On the other, because the market sensitivities can change suddenly structured products are exposed to barrier breaches and loss of capital.

"A good example was March 2020 when many structures with down and in puts (soft-protection) became similar to stocks in terms of sensitivity – this changed the risk profile of those products and impacted many portfolios, and funds using autocall structures," said Montero.

KEY CHARACTERISTICS

The ELDeR fund's delta target is between 40-60% which means that when there is a risk of falling out of that range, the portfolio can be rebalanced quicker and easier than if we had invested in autocallables.

"We have a three-year track record and the fund has performed as expected," says Montero, adding that the other key element of the fund is the risk management approach.

"We get the premium by selling options although we prefer put spreads, or digitals - they may give you less premium but prefer them to down and in puts where the delta increases a little when there is a slight correction but the closer you get to the barrier the higher the potential loss. If the market goes to zero, the option will be worthless.

"We want to have a stable risk on our exposure to equities and we're happy to give up some upside to have more protection when market corrections happen."

The ELDeR fund total return since inception is around 3.5% "with half or one third of the realised volatility in the equity market".

"From a vol and drawdown perspective our fund is the less risky out there among its peers," says Montero. "From a yield perspective we're not too behind the best."

The fund also incorporates ESG criteria in the portfolio construction and is currently rated AAA ESG by MSCI.

UK regulators promote Sonia in structured products Libor shift

The Working Group on Sterling Risk-Free Reference Rates' paper on the transition of structured notes away from GBP Libor provides practical steps for market participants seeking to transition notes with a derivative component.

The paper also contains feedback from the UK Structured Products Association (UK SPA) and the Bond Market Sub-Group. For new business, the paper suggests overnight Sonia, compounded in arrears, as a potentially suitable alternative rate and offers considerations around calculation conventions. For the transition of legacy products, it stressed the need for engagement between product manufacturers and distributors, 'especially where consent solicitation may be necessary to transition a product'.

This paper builds on previous work on transition in other parts of sterling markets, to describe how a sterling structured product market based on a risk-free rate could potentially be designed using compounded in arrears Sonia, and to set out considerations for the transition of existing sterling structured products from GBP Libor to Sonia.

The report from the Working Group, comprised of the Bank of England and the Financial Conduct Authority (FCA), aims at supporting market participants including issuers, manufacturers, distributors and investors, to meet the recommended milestones and priorities for transition by end-2021, and refers to various types of structured products, including on-balance sheet issuances and repackaging transactions.

The recommended roadmap for transition outlined by the Working Group includes the cessation of issuance of new GBP Libor-linked loans, bonds, securitisations and linear derivatives except for risk management of existing positions that expire after the end of 2021 by end-Q1 2021, as well as new GBP Libor-linked non-linear derivatives except for risk management of existing positions that expire after the end of 2021 by end-Q2 2021, and new cross-currency derivatives with a Libor-linked sterling leg, expiring after 2021 During Q2/Q3 2021.

In addition, the regulators expect progress in the active conversion of all legacy GBP Libor contracts where viable through to completion by end-Q3 2021.

'Market participants are encouraged to take all necessary steps to complete their operational transition plans for structured products in order to reduce the financial stability risks arising from the widespread reliance on GBP Libor and to support an orderly transition ahead of end 2021,' stated the regulators. 'To assist with this, it may be beneficial for participants to consider issuing new structured products based on compounded in arrears Sonia'.

KEY CONSIDERATIONS

The Working Group believes that a Sonia rate compounded in arrears 'will and should become the norm in most sterling derivatives, bonds, and bilateral and syndicated loan markets given the benefits of the consistent use of benchmarks across markets and the robust nature of Sonia as a reference rate'.

New structured products referencing compounded in arrears Sonia that have a derivative-linked payout or coupon (for example, a product featuring a payout with a cap or a floor) would be inherently linked to the corresponding derivatives markets based on compounded in arrears Sonia.

In the linear derivatives market, there are already strong levels of liquidity in swaps based on compounded in arrears Sonia, with trading in GBP Libor having reduced in line with the recommended guidelines. For non-linear derivatives, the regulators expect conventions and trading practices to be established and liquidity on compounded in arrears Sonia to develop, 'supporting in turn the development of a new structured products market on this basis'.

In relation to the transition of legacy GBP Libor structured products the paper provides high level contractual fallback language and potential steps to facilitate transition as there is 'a significant degree of variation across fallbacks in structured products programmes, particularly over the last three-four years in response to the evolving regulatory landscape and developments related to Ibor transition'.

POTENTIAL HURDLES

However, the paper notes that the structure of certain legacy products may limit the feasible transition options, and that while some programmes, mainly off-balance sheet repackaging programmes, contain fallback provisions that are highly bespoke, the trend for most structured products programmes has been to include some or all on broadly defined categories of fallbacks.

As reported, implementing the new Isda fallbacks could be problematic for range accrual products. According to the paper, although a GBP Libor-linked range accrual product may operate from a mechanical perspective if transitioned to compounded in arrears Sonia on the basis set out in the Isda Protocol, its economic profile could be materially different from its original intended form.

'For products such as these, issuers and manufacturers may want to consider a range of available approaches to transition, including transition on the basis set out in the Isda Protocol, to determine the appropriate approach for individual products and investor classes,' stated the regulators. 'Issuers may seek to restructure legacy products so they reference compounded in arrears Sonia in the same way that a new issuance would.

> “The structure of certain legacy products may limit the feasible transition options

In determining the appropriate course of action, issuers and manufacturers will need to consider alignment with associated hedges and the possibility of value transfer.'

The paper recommends the alignment of the terms of the instruments themselves to related derivatives transactions to ensure that any credit adjustment spread (CAS) upon transition to Sonia does not disrupt the economics of the product, and warns potential hedging mismatches.

In a repackaging structure, the issuer of the repack securities will usually enter into a hedging transaction with a bank swap counterparty, which in turn will hedge its obligations in the market

However, structured product programme documentation is not standardised across the market, whereas the market-facing hedging activity will usually be under standardised Isda documentation.

As a result, there is potential for mismatch between the GBP Libor fallbacks and triggers applicable to the structured product, which vary widely depending on when they were drafted and the policies of the individual issuer or arranger, and those applicable to the related market-facing hedging derivatives.

'Any of these could result in a discrepancy between amounts received by the issuer (or in the case of a repackaging, the swap counterparty) under its market-facing hedge and its corresponding liabilities,' stated the regulators. 'Issuers and manufacturers may wish to consider identifying any areas of potential mismatch that may arise and determine how to minimise or avoid it in the proposed changes to contractual terms and cash flows, ahead of implementing their remediation strategies.'

Structuring: inflation fear impacts market volatility

When the VIX is in contango - second-month futures higher than front-month futures, as is often the case - shorting volatility via exchange-traded notes (ETNs) like VXX provides an additional return via the roll yield.

> “When inflation is low, rising inflation is a good thing for stocks

However, the last volatility shocks pushed some players away from short-vol bets, according to Rocco Longo (pictured) and Francesco Fedele, global markets structurers at Intesa Sanpaolo.

In this environment, vanilla options are preferred to variance swaps and other instruments (ie ETNs like the XIV) while ‘sold-put-options’ are the choice for yield enhancement payoff – sigma certificates where the short out-the-money put vanilla funds the long call option.

Vanillas are even easier from a risk management point of view and mostly used to hedge exposures coming from the structured product business, according to Fedele.

“The gap between implied and realised volatility is still high - the banking sector shows a sustained skew for example,” he said. “The hedging demand maintains the volatility risk premium elevated. After the recent sell-off, people wanted to buy protection. Despite being in a calmer market, the volatility and rotation between growth and value stocks shows how nervous equity investors are about higher real yields.”

Looking at the past, implied volatility remained elevated for more than a year after the 2008 global financial crisis: in other words, the market could be facing higher volatility in the coming months, above its long-term average, even considering the ongoing elevated uncertainty.

“We will slowly return to a normal volatility environment, driven by structured product activity (supplying vega) and by more investors that piled into option selling strategies,” said Longo. “The excess premium between implied volatility and realised volatility will be suppressed as soon as sellers outnumber protection buyers (long options, creating positive vega/gamma).

“We can even expect positions to be levered up to exploit the moment, adding more negative gamma and vega risk, and deeply affecting (or amplifying) the market direction, even considering the current lacking liquidity.”

Year-to-date, the market has been very focused on thematic baskets - even in terms of market inflows in the ETF space, featuring airlines, electric vehicles and reflation names among the most traded stocks, according to Fedele (right).

"Generally speaking, investors see further gains for cyclical and value stocks," said Fedele. "Inflation, retail sales, and industrial production are still the most pronounced words across financial news. In particular, after the CPI inflation surprise to the upside – even thanks to the so-called base effect - a lot of analysts think it is transitory."

Inflation is currently considered the greatest tail risk. "The fear of more inflation, which could drive up interest rates, could weigh on equity valuations," said Longo, adding that a worrying sign was the deep drop of the Nasdaq 100 index with some stocks falling below their 200-day SMA for the first time since March 2020, affecting some path dependent products with barriers.

"It is not clear if inflation is a bad thing," he added. "When inflation is low, rising inflation is a good thing for stocks. In such a scenario the risk of deflation goes down. At the same time, a stronger economy pushes inflation and stocks up. Everybody is looking for assets to protect their purchasing power. Traders looked to hedge their portfolios from inflation risks. That's another (or maybe the main) factor that explains the commodity boom."

In fact, commodity prices have support from investors seeking real assets that tend to appreciate when inflation becomes a bigger risk in portfolios. For instance, lumber has more than tripled, according to Fedele.

"Copper, corn and gasoline futures all cost about twice what they did a year ago, when the whole globe was locked down to fight the spread of covid-19," he said, adding that traders of TIPS use the Brent crude to offset risks. "On the US side, soaring commodity prices have stoked fierce debate over inflation and whether the fiscal and monetary policies intended to buffer the economy during the pandemic might now risk hobbling the recovery."

At the same time, equity investors are taking some profits after a good start to the year.

"Sell in May and go away," said Longo. "We also have to consider the impact of the high gamma open interest. The option exposure plays a big role. When the market falls and/or the implied volatility rises, dealers' delta hedges have an extra impact."

In this context, the VIX index and skews spiked again which resulted in dealers taking this spike to continue generating carry by selling volatility.

The trend seems to be supported by the CBOE Eurekahedge Long Volatility Index [EHFI451 Index], a good proxy for long vega strategies, according to Longo.

Longo also noted that the market today works with a different normality - hedging the upcoming known event, using mainly short-dated options which led implied volatility to spike for just a couple of days to revert back to a new normal.

"One-week dated calls and puts attracted a lot of attention," said Longo. "These very short contracts allow investors to capitalise on volatility via constructing gamma hedges around such important events - gamma is highest for options that are at-the-money and nearing expiry.

"In addition, the non-linear profile or convexity makes the gamma trade more appealing. Even retail activity appears to be substantially higher in the options market than in the cash equity market, with an elevated demand for short-dated options on low volatility names, playing covered call, protective put and other strategies."

CBOE Eurekahedge Long Volatility Index

Source: Bloomberg

Scotiabank: adding corporate commitment to traditional ESG indicators

The Mexican arm of the Canadian investment bank has rolled out its first MXN-denominated structured note linked to the IndexAmericas, a corporate sustainability index developed by the Inter-American Development Bank (IDB) and commercialised by BNP Paribas.

> **We are very confident ESG focused products will attract more attention**

Following the launch of the first sustainable play in Mexico via a proprietary index developed by BNP Paribas, SRP spoke to Juan Antonio Carrancedo, head of Scotia Wealth Management Mexico, about then choice of underlying for the inaugural launch, the increasing traction of ESG in the Mexican market and how structured products can provide efficient access to this thematic.

"This is the first time Scotiabank México issues a structured note of this kind," said Carrancedo. "We are very confident ESG focused products will attract more attention in the near future, offering more sustainable alternative investments for the Mexican market."

How did the idea for the partnership came about?

Juan Antonio Carrancedo: With the growing enthusiasm about ESG and sustainable finance products in the Latin America Region, the IDB and BNP Paribas have been collaborating closely to use the IndexAmericas methodology to develop diverse products that could be attractive in the market. In the context of this collaboration, Scotiabank came along as an additional partner that shares BNP Paribas' and the IDB's commitment to promoting sustainable finance and economic resilience. We are proud to work as partners that share values, the belief in the importance of sustainable finance, and the commitment to boosting sustainable socio-economic development in the region.

The great thing about this strategy is the incorporation of 50 US-listed companies well positioned globally

The partnership builds on IndexAmericas, a family of corporate sustainability indexes created by the IDB in 2017 to promote corporate sustainability in Latin America and the Caribbean (LAC). As such, this novel ESG product was issued by Scotiabank, structured by BNP Paribas, and linked to the IDB's IndexAmericas 50, an iteration under this family of indexes that recognises 50 publicly listed US firms that demonstrate a commitment to ESG issues and sustainable development in the region.

What are the main characteristics of the new structured note?

Juan Antonio Carrancedo: The product issued by Scotiabank is a MXN-denominated structured note linked to the IndexAmericas 50 Stability Excess Return Index (IDBTVER Index) which includes a volatility target of six percent.

The index, developed by the IDB, structured and commercialized by BNP Paribas, includes 50 US-listed companies with strong commitments to sustainable development and ESG issues, as well as a sizeable footprint in Latin America and the Caribbean [LAC]. The three-year structured note includes a leveraged call option and principal protection of 100% to maturity.

What is unique about this index?

Juan Antonio Carrancedo: The great thing about this strategy is the incorporation of 50 US-listed companies well positioned globally but with the great difference that they maintain a relevant market share and generation of income in the LAC region. BNP Paribas sales and structuring built a tailor-made version of the original IndexAmericas to meet Scotiabank's specific needs for the Mexican market and bring efficient diversification to clients through this unique investment solution.

The IDB Group's IndexAmericas promotes corporate sustainability in LAC. It is the first corporate sustainability index created by a multilateral development bank and is unique in the market given its addition of a fourth pillar that assesses corporate commitment to sustainable development (in addition to traditional ESG indicators).

In addition, it is the first corporate sustainability index in the LAC region to be fully aligned with the United Nations Sustainable Development Goals (SDGs).

IndexAmericas has developed several iterations of its Top 100 Index, which recognses 100 leading global companies operating in LAC along these lines. In addition, IndexAmericas has produced multiple editions of its Multilatinas Index, which assesses the performance of LAC-based companies, as well as a Gender Index that showcases corporate leaders on gender equity issues.

IndexAmericas has a unique and proprietary IDB Group methodology, developed in partnership with S-Network Global Indexes. The initiative is powered by data from Refinitiv and it receives academic support from the Earth Institute at Columbia University.

Is demand for ESG products increasing in Mexico?

Juan Antonio Carrancedo: We think it is changing rapidly and it will grow more and more in the following years. Over the last two years, we have seen more Mexican companies focusing on this matter, and ESG investments have become more relevant for businesses due to the problems faced in various sectors and industries.

Also, in 2020 the pandemic represented a main driver for change and it opened a big opportunity to remember the importance of these three concepts: environmental, social and governance.

We are convinced that the implementation of ESG metrics and policies have a positive effect on the productivity and profitability of the companies around the world and definitely Mexican investors are starting to perceive this change and demanding investment strategies with this attributes to be included in their portfolios.

A more sustainable way for the companies to invest is creating more opportunities for future generations.

> **“The partnership builds on IndexAmericas, a family of corporate sustainability indexes created by the IDB in 2017**

DDV: plugging the structured products gap on new SFDR

The German trade body has moved to fill a regulatory gap as structured products are not currently covered by the EU Sustainable Finance Disclosure Regulation (SFDR).

> **The initial EU framework did not have structured products in mind**

Following the release of the new Sustainable Finance Code of Conduct which sets out uniform product and transparency standards for sustainable structured products in Germany by the German Derivatives Association (Deutscher Derivate Verband, or DDV), SRP spoke to Dr Henning Bergmann (pictured), CEO and member of the board of directors of the DDV, about the new guidelines and the challenges around ESG adoption and 'greenwashing'.

The Code of Conduct distinguishes between ESG Products where the issuer defines one or more dedicated sustainability strategies in advance for the selection of the underlying, and ESG Impact Products - impact-focused bonds that 'pursue one or more measurable sustainability objectives' such as funding economic activities that contribute to the defined sustainability objectives.

Why do you think these principles are needed?

Henning Bergmann: We are convinced that the DDV Sustainable Finance Code of Conduct can enhance trust in the market by offering transparent information for clear ESG product categories. When it comes to promoting sustainability by investing capital, we want retail investors to know that there are structured retail products on the table to choose from that reflect a variety of ESG strategies.

Can you talk us through the process of creating the Code of Conduct? What criteria did you use to measure sustainability objectives?

Henning Bergmann: Firstly, the Code of Conduct establishes the requirement to have a clear ESG strategy defined by the product manufacturer, without limiting the investment universe for the investor in principle, except from some minimum exclusions regarding the underlying.

Secondly, the Code of Conduct contains transparency requirements so that investors can make informed investment decisions. Finally, we introduced the distinction between the bond component and the derivative component of a structured product, with the bond component linked to the general business activities of the issuer.

This introduces principles-based guidance with regard to the sustainability of the issuer, which again needs to be disclosed to the investor. For products defined as ESG Products, this comes with a reference to an ESG rating reflecting the ESG performance of that issuer. For products defined as ESG Impact Products, which reflect the regulatory requirements of article 9 of the Sustainable Finance Disclosure Regulation, DDV members will follow a use-of-proceeds approach as is practiced, for example, when issuing green bonds.

Is there concern in the industry regarding the misuse of the ESG label as a marketing fad?

Henning Bergmann: We have refrained from labelling and decided to agree on a code of conduct. We have chosen a transparent approach to make the maximum information about the underlying ESG strategies of the respective products available to retail investors. And we have defined two product categories with graduated degrees of ESG effectiveness.

Compliance with the DDV Sustainable Finance Code of Conduct will be regularly reviewed by the Sustainable Finance Code of Conduct Advisory Board. So, we believe we are doing a lot to prevent any suspicion of greenwashing.

When will the DDV Sustainable Finance Code of Conduct logo be widely implemented by the issuers?

Henning Bergmann: Our members can start immediately. And we know that there are structured products that already comply with the Code of Conduct, which we expect will be gradually implemented more and more in the months to come. For us, the relevant date is the entry into force of the amendments to Mifid 2 to take into account sustainability factors and preferences with regard to product governance requirements. Then, the DDV Sustainable Finance Code of Conduct will officially take effect.

From that moment on, its application becomes binding when members publicly offer their sustainable structured investment products to retail clients in Germany. We want retail investors to know that there will be a large variety of sustainable structured products for their individual ESG strategy at their disposal.

Is the German structured products market the first to offer uniform ESG standards to its retail investors?

Henning Bergmann: It is one of the first, as far as we know. In other jurisdictions, such as France, the structured products industry is also reflecting on standards, potentially followed by external certification and validation from public authorities.

What stage are regulators in Europe at regarding the development of ESG standards for structured products? Do you think the DDV's principles can be applied across Europe?

Henning Bergmann: The initial regulatory framework was not designed at the EU level with structured products in mind, which explains why they were not directly scoped in. We hope that the DDV's initiative will make EU regulators increasingly sensitive to the contribution of structured products to the area of sustainable finance. Ideally, we also hope that the DDV's principles may serve as a basis for developing converging standards across Europe.

What does the DDV need to ensure that its objective to provide transparency and reliability for sustainable investment in structured products is met?

Henning Bergmann: We are already on the right path. First, the Code of Conduct is binding for our members, who all agreed to its establishment. Furthermore, we build on widely known and established ESG standards and metrics wherever possible. Finally, compliance with the Sustainable Finance Code of Conduct will be regularly reviewed by the Sustainable Finance Code of Conduct Advisory Board.

There are structured products with no ESG underlying or green bond component that are using proceeds for social causes – in what category would these products fall under the new standards?

Henning Bergmann: According to the Sustainable Finance Disclosure Regulation, sustainable investments are not limited to pursuing environmental objectives. So, indeed, if the proceeds were used for social causes, they could fall under the category of ESG Impact Products, just like green bonds.

“

Compliance with the DDV Sustainable Finance Code of Conduct will be regularly reviewed

We aim to offer an ESG version for every existing product

The Covid pandemic has triggered interest in new thematics around the winners and losers, and the sectorial dispersion of the new world - robotics, healthcare, artificial intelligence, video gaming, are areas that have benefitted from the 'work from home' environment.

However, according to Patrick Kondarjian, global co-head of ESG sales, markets & securities services at HSBC, ESG remains a focal point for the bank with activity around social bonds increasing faster than other segments.

Is there a lack of understanding from clients about what is ESG? What kind of conversations do you have with clients when it comes to ESG?

We tend to see ESG as a theme and, therefore, from this standpoint we explain to clients how to approach ESG – then you can go one level down and discuss different ways to implement ESG at a product or portfolio level. The starting point is to understand client objectives: risk appetite, target return, liquidity ... and ESG approach.

The right solution must address this combination of objectives. This can be done with structured products and other instruments, so it is important to look at the wider picture before discussing ways to deploy ESG in a portfolio.

This also helps the buy-side to have a meaningful conversation with their own clients. Ultimately, ESG structured products are a variant of conventional investments incorporating this key new dimension into the investment process.

What is HSBC's approach to ESG? How do you pitch ESG to clients?

The way I would describe ESG is i) a theme ii) a risk factor and iii) a revenue driver.

ESG has become a theme that crosses everything in the financial markets and a factor in its own right. In the same way you have credit and regulatory risk, you now have a new risk factor as you could be exposed to the environmental, social and governance risk – every major market participant is incorporating ESG into their broader risk analysis.

Additionally, ESG is a return driver. We have seen over the last few years how ESG strategies have performed which in turn is bringing new inflows. Changes in regulation to build standards and transition towards a green economy (decarbonisation) have opened up new opportunities – in 2020, we saw valuations going up in several sustainable sectors (e.g. clean energy), resulting in higher returns.

ESG has become an umbrella term covering different sectors and companies that are benefitting from the overall ESG megatrend. We don't look at ESG as a standalone product but an additional dimension and a risk factor to consider at the product development stage.

There are different ways to invest in ESG – green bond, underlying, positive impact. Is this adding confusion among investors?

It is important to understand the different components of an investment and the function they play and how they interact. There may be some confusion among investors because of the different labels being used (green, ESG, sustainable, SRI) and also the increasing number of products – while this increases choice, it can, however, make it more difficult for the end-investor to identify the right investment for them.

HSBC categorises products in three ways. First, we have 'enhanced' products that are based on ESG inclusions/non-ESG exclusions; then we have 'thematic' products that provide a specific theme in the ESG world like plastic reduction or diversity; and finally we have 'impact' products that are used to finance green/ sustainable and social projects.

The three categories are contributing to the ESG agenda in different ways. When you apply screenings and filters to an investment strategy, the focus is not on financing projects but on selecting companies that have good ESG credentials and excluding those that don't. With thematic products, investors are channelling money towards specific areas and sectors at the forefront of sustainable developments and for expected returns.

Impact products is the category many manufacturers are currently focusing much of their energies on, as you're not only serving the end-investors with an interesting investment proposition but you are also able to support projects that will have a real positive impact. This is the category where there is less capacity in the market presently because you must have the projects you want to support available, and those are in limited supply, but this should grow over time.

What is the USP of ESG?

As a product provider we aim to offer an ESG version for every existing product and service (where appropriate), enabling our clients to achieve their ESG objectives. These are multi-faceted, mostly driven by value (risk/return), values (ethics) and regulation (e.g. SFDR), based on our findings.

Our role is to help investors on this journey, providing insight and options that fit their objectives and constraints; it's often a balancing act, especially when they have large assets to allocate.

There is also an economic imperative – how do investors balance liquidity, market size and capacity versus what they want to do, as the different products contribute differently to the ESG agenda. The good thing is that you have different tools to achieve different ESG objectives that can be used solely or in combinations with others.

ESG is not a one-size-fits-all: it is important that there is a high level of disclosure, transparency and education so that investors are aware of the different options at the point of sale.

How do structured products fit within this transition towards a greener economy?

The process of capital allocation creates incentives for companies to transition, and that can drive demand for ESG structured products.

> “**We don't look at ESG as a standalone product**

Each of the three categories we have described contribute to the ESG shift. ESG indices often have exclusionary filters which means that less capital is going to be invested in companies involved in controversial weapons, tobacco, gambling, etc., while others follow a best-in class approach through which an investor may favour (allocate more capital to) companies that are aligned with stronger ESG principles. All of this affects security prices, which matters to investors, board directors and management teams.

The thematic category also comprises dedicated and purpose-built indices or baskets of securities consisting of companies with a strong ESG profile. The impact category (e.g. green structured notes) directly allocates capital towards specific green or sustainable projects (specific use of proceeds), and the end-investor can see where the money is going.

We think the right approach is from top to bottom as you can then look at the economic considerations before choosing a particular instrument or strategy.

How would you describe HSBC's ESG offering?

We have developed a full range of solutions over the last six years. HSBC was one of the first banks to engage in this space – we now have a full catalogue of investment options across regions.

On the wrapper side, we have our Green Bond wrapper and our UN SDG wrapper which we have used in the US, for example. We have also developed a range of indices in collaboration with major index providers that can provide us with the knowledge, depth of research and trusted methodologies you need to develop sound ESG investment strategies.

Our approach then is to adapt the strategies to the different markets and clients we serve. We have responded to demand in markets like China and the US, and several countries in Europe where ESG is growing fast.

The private banking space has been one of the areas where the pick-up in ESG has been more apparent over the last 18 months from a thematic approach. In this area, we are going into the specifics of ESG and looking into areas where there is a growth potential for investors to capitalise on those trends.

Our research capabilities are key to screening the ESG universe and identifying themes around revenue exposure, stocks with strong growth potential, liquidity, valuations, etc. This enables us to select baskets of stocks that we can deploy via structured notes.

What opportunities do you see around ESG?

The intersection of ESG with factor investing is also an area of focus for us as it makes sense to combine relevant factors with ESG. There are also opportunities around multi-dimensional problems – for example, a client switching from a traditional global index benchmark to its ESG version while also requiring systematic FX hedging embedded into the index itself.

The message here is that we can embed ESG wherever it is needed to achieve the client's goal; and, because ESG is multifaceted – some clients look for impact, others for risk mitigation – there is a bespoke element that allows us to leverage on our structuring capabilities.

EXPERT VIEW

Esma report on retail products: interesting, but inaccurate

In April 2021 the European Securities and Markets Authority (Esma) published its annual statistical report on the performance and costs of retail products.

Image: Austin Distel/Unsplash.

This wide-ranging document (over 100 pages long) makes for interesting reading, not only as a summary of the European investment landscape, but also to get some insight into the thinking of the European regulators.

The first comment that could be made is one of timeliness. The EU's political and regulatory machinery is known to be methodical rather than nimble – but to take over 15 months to compile and publish an annual report seems excessive and particularly unfortunate this year as it has not included anything of 2020.

The report centres around Ucits funds, alternative investment funds (AIFs) and structured retail products. It states the approximate size of these three markets, €4.5 trillion for Ucits, €1 trillion for AIFs and €400m for structured products. This means that structured products make up around 15% of this total which is therefore a significant slice of the overall market.

The Esma report contains high level analysis of the performance of each sector. It comments on the lack of readily available data for structured products, although it does later reference statistics from structuredretailproducts.com and others.

Esma notes that it has now created a database of submitted Priips documents for structured retail products. This is a useful function for a regulator to perform in the era of digital based regulation both to provide market feedback and to shape future regulatory changes. It may also be revenue generating and the idea is like the European DataWarehouse initiative by the European Central Bank for collecting loan level data for asset-backed securities.

This article will concentrate on the structured products section of the report. These sections are interesting but do contain some inaccuracies and biased statements, such as the observation that "[…] unlike long-term investment products such as funds, many structured products may be designed for hedging purposes or to speculate on price movements over the period of months or years. Consequently, structured products should – as a general rule – not be regarded as long-term investments in the same way as funds."

This rather lazy comment overlooks the success that can be achieved by a diversified portfolio of regular investment in structured products and other assets. Given some of the other statements in the report, it would be good for Eusipa to contribute next year to help address this imbalance.

The report makes the high-level observation that capital-at-risk products have increased from 19% of the market in 2009 to 64% in 2018, which it correctly attributes to low interest rates which have made structuring capital-protected products much harder. It also states that the number of products issued annually has increased even though total market size has remained roughly constant, leading to a lower average size per issue. It does not really comment why this has happened, which is down to a combination of technology improvements and automation making greater issuance easier, increased competition between distributors and often uncertain investment demand leading to distributors trying different product types to capture as much demand as possible.

The report uses some of the Priips data it has started to collect to observe that for many structured products there is little difference between the moderate and favourable scenarios, unlike for funds for example. Although not stated in the report, this result is actually quite intuitive given that many structured products (autocalls, reverse convertibles, capped protected) deliberately aim to give fixed returns in flat to mildly positive scenarios and to control risk on the downside, meaning that both the moderate and positive scenarios will achieve their target returns.

The report also contains many interesting tables and charts showing investor trends over the last 10 years in its statistical annex. This shows several themes, such as the mix of household assets which is very broadly stable, except for the decline in debt securities as rates have fallen. It also shows that the value and number of Ucits funds has increased over the last 10 years, with the notable exception of France. Institutional usage of Ucits funds has increased from almost zero 10 years ago and has kept pace with the increase in the number of retail funds.

One of the biggest growth sectors in the last 10 years is that of AIFs. Although it is still a small part of the retail market, one of the charts indicates that AIFs have almost as much AUM as equity and bonds. AIFs are mentioned elsewhere in the report, though with rather less detail than structured products. Various comments are made about availability of performance data for AIFs. This is caused in part by the fact that this sector has been slow to adopt the spirit of transparency envisaged by the AIFMD regulation which came into effect after the implosion of the asset class in the 2008 financial crisis.

Other important themes also get some attention, such as the rise in number of ESG funds and an indication of their favourable performance and cost levels. Brexit gets no direct mention although a table of Ucits domicile by country shows UK ahead of Ireland for both retail and institutional share classes. It will be interesting to see how this plays out in the next few years.

The whole paper is worth a look but I believe it would be better served by a more streamlined report, with data offered by download and a faster annual publication cycle to keep it relevant in today's fast moving world.

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The whole paper is worth a look but I believe it would be better served by a more streamlined report

EXPERT VIEW

The VIX 'fear' index: a justified nickname

The VIX index is a measure of implied volatility of the S&P 500 index. It was first created in 1993 and uses liquid exchange-traded options on the S&P 500 at (or nearest to) 30-day maturity to calculate a precise value for implied volatility.

Image: Meg Boulden/Unsplash

Over the years, the VIX has become an important barometer of market activity. It is sometimes known as the fear index since high levels of the VIX demonstrate high market volatility and with the expectation of possible large future moves, the fear that they could be on the downside.

The notion of implied volatility (as opposed to the simpler historical) has been well known since the Black Scholes option pricing formula was devised. Some 20 years later (the early 1990s) the idea of local volatility models was formulated by Dupire, Derman and others.

This significantly extended theory beyond Black Scholes and helped provide a more complete view of pricing and risk management because of the way it combines options of different strikes to provide a two-dimensional view in strike and maturity. Shortcomings in the local volatility framework have since been well documented and, today, other models such as stochastic volatility are now considered more reliable. However, its contribution remains key and its development provided the inspiration behind the concept of the VIX which was first introduced by CBOE during that period. The calculation is a little technical and has been applied to many other indices (such as the Nasdaq, Eurostoxx and FTSE 100). It is also calculated for several different maturities ranging between nine days and one year.

In the US at least, just by knowing the level of the S&P 500 and the VIX, traders can get a very good sense of where the market stands and is heading. The highest level recorded by the VIX in the last 10 years was 82% in March 2020 during the Covid-19 market shock. This is equivalent to a volatility level normally associated with speculative stocks or troubled companies. By contrast, the lowest value seen over the last 10 years is just below 10%, with the long-term average around 20%.

In the years since it was created, the VIX has assumed a further importance which was probably not envisaged at the outset. This can be divided into two categories, market predictions and financial instruments.

PREDICTIVE POWER

The VIX represents a single measure of implied volatility which is sometimes taken to indicate the markets prediction of future volatility but translating this to concrete advantage is difficult, particularly as volatility is a second order quantity with mean reverting behaviour. A natural question is how much predictive power the level of the VIX has in estimating future volatility.

To test this, we analysed S&P volatility and the VIX since 2007, a substantial time period covering many market cycles. The R squared regression number for future realised 30-day volatility against the VIX level is 51%. This compares to 43% when regressing future realised volatility against current historic volatility. Therefore, the VIX is slightly better than historic volatility in predicting future volatility. Given that the market can only price in what it sees today it is perhaps unreasonable to expect the VIX to be a stronger predictor of market volatility.

The other observation we can make from the same data set is the strong negative correlation between the VIX and the S&P 500. This was measured at -70% over the same period, showing that an increase in volatility strongly tends to accompany market declines showing that the VIX's nickname of the Fear Index appears justified. Many trading strategies have been devised to try to extract value from the subtle and changing relationship between the VIX and the market itself.

This leads to the second category which is the inevitable proliferation of direct financial instruments such as futures, ETFs and further indices that track the VIX in some way. Examples include the S&P 500 Vix Mid-Term Futures, ProShares Short VIX Short-Term Futures ETF, iPath S&P 500 VIX Short-Term Futures ETN (source www.structuredretailproducts.com).

Such instruments do not always behave exactly as anticipated for technical reasons. Although the VIX methodology means that a value can be assigned daily or real-time, this does not necessarily mean that translating it into an investable asset is straightforward. Various technical carry effects mean that such instruments may not perfectly mirror actual changes in the VIX itself. In this regard it has more in common with commodity indices rather than equity. The calculation of the VIX is derived from the value of options of different strikes and therefore hedging the VIX will in general require using much of the same universe. This can incur costs due to transactions or liquidity.

Further developments have included ETFs linked to leveraged and short versions of the VIX. As with all such extended versions of an index accuracy and governance is key. A recent enforcement from the SEC fined the index calculation agent S&P Dow Jones for publishing stale values of a short VIX future based index during a day of market volatility in February 2018. Given the attention that surrounds indices under the Benchmark Regulation and the pivotal role the VIX now plays in the market there is a lot of responsibility on index providers and ETF issuers.

I expect that the VIX will continue to play an important role in the market and its creation remains one of the most important developments in the financial world in the last 30 years.

“

The VIX represents a single measure of implied volatility to indicate the markets prediction of future volatility

Product wrap: SG endorses Biden's clean energy revolution

In this month's wrap, we look at a selection of structured products with strike dates between 16 May and 12 June 2021.

EUROPE

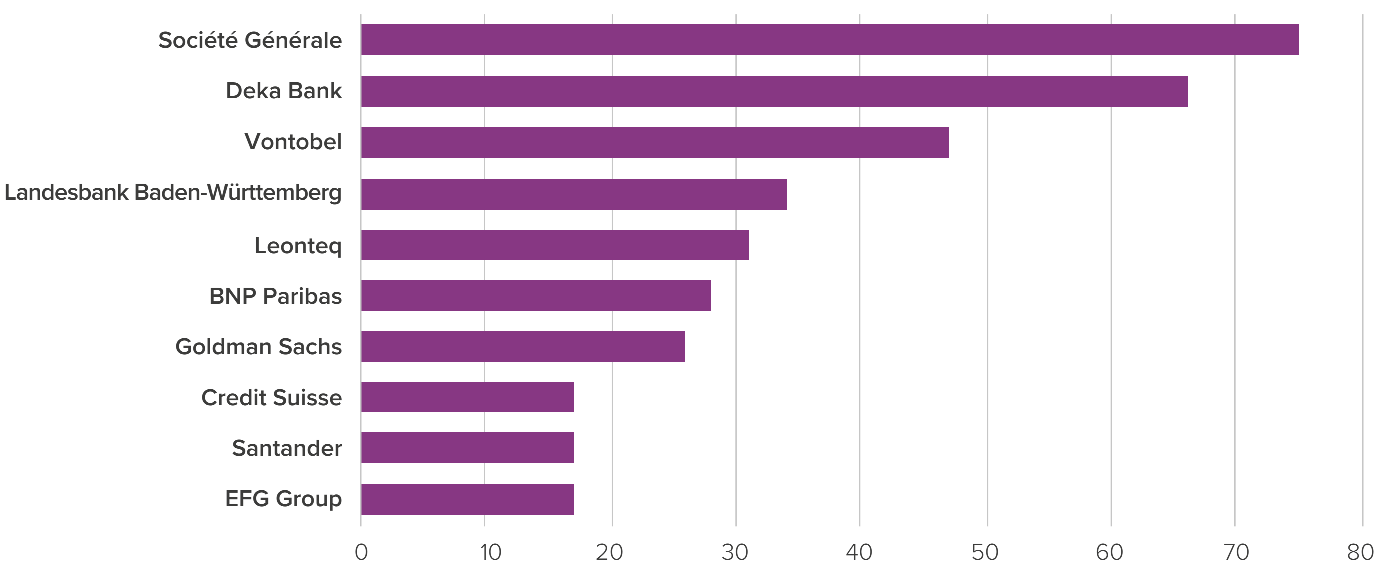
Sirius Asset Management collaborated with Société Générale for the launch of S*AM Greener America NR 2116 in Sweden. The product offers 100% participation in the upside performance of the proprietary SGI Greener America Ahead NR USD Index – adjusted for changes in USD/SEK currency exchange rate and subject to a minimum capital return of 50%. The index is calculated and maintained by Solactive. It comprises 48 stocks of companies which might benefit from Presidents Biden's plan for a 'clean energy revolution and environmental justice'. The note is targeted at private banking clients and issued at 46% (SEK4,600). A commission fee of 6.12% is added to the issue price. Priips SRI: four out of seven.

Deutsche Bank collected €7.6m with Asian Equities Note USD 2029 in Belgium. The 8.6-year, capital protected medium-term note (MTN) is denominated in US dollars and issued via Credit Suisse. It participates 100% in the potential rise of the MSCI AC Asia Pacific Index, which has 1,553 constituents and captures large and mid-cap stocks across five developed markets countries and nine Emerging Markets countries in the Asia Pacific region. The return is capped at 40% and subject to 24-month backend averaging. Although the product is listed in Luxembourg, it does not provide access to an active market. Priips summary risk indicator (SRI): two out of seven.

Kempen launched VLKWM Trigger Plus Note Eurozone 21-25 in the Netherlands. The four-year autocall is linked to the Eurostoxx 50 and issued on the paper of Van Lanschot Kempen Wealth Management NV. Every year, it pays a memory coupon of four percent providing the index has not fallen below 80% of its initial level on the valuation date. At maturity, a European soft capital protection barrier of 70% applies. Priips SRI: five out of seven.

Oddo BHF Banque Privée is distributing Performance Lock-In in France. The eight-year MTN is issued via Credit Agricole CIB Financial Solutions and linked to the share of

Europe: top 10 issuer group by issuance - 16 May to 12 June 2021*



*Excluding flow- and leverage products

Source: StructuredRetailProducts.com

Total. At maturity, it offers 150% participation in the positive performance of the share. If the share has fallen below 70% of its starting price, the product participates 1:1 in the fall. However, if, at any time during the investment period, the share has risen by 19%, a lock-in feature is activated, and the capital is preserved at maturity. The product is listed in Luxembourg and a one-off entrance fee of 0.51% applies. Priips SRI: six out of seven.

Leonteq is selling an Express Certificate on an index basket comprising the Dax, FTSE MIB, and OMX Stockholm 30 in Italy. Each quarter, the product offers a memory coupon of 1.25% providing all indices close at or above 60% of their strike levels. It redeems early, quarterly, if the indices close at or above a predetermined amount of their initial level on the valuation date – starting at 100% for the first three quarters; 95% for quarter four to seven; and 90% for quarter eight to 11. EGF International Finance is the issuer and the product can be traded on EuroTLX, the multilateral trading facility of Borsa Italiana. Priips SRI: four out of seven.

NORTH AMERICA

BMO issued Callable Equity Income Notes, Series 2276 (CAD) in Canada. The product pays a monthly digital coupon of 6.27% pa if the underlying Solactive Canada Insurance AR Index closes at or above 70% of its initial level on the valuation date. If the index is above 70% at the scheduled maturity date, the product returns full capital. Otherwise the product returns capital at a rate equal to the fall of the index. A selling concession of C$2.50 per note sold applies while an additional fee of up to C$0.20 will be payable to Raymond James for acting as independent agent.

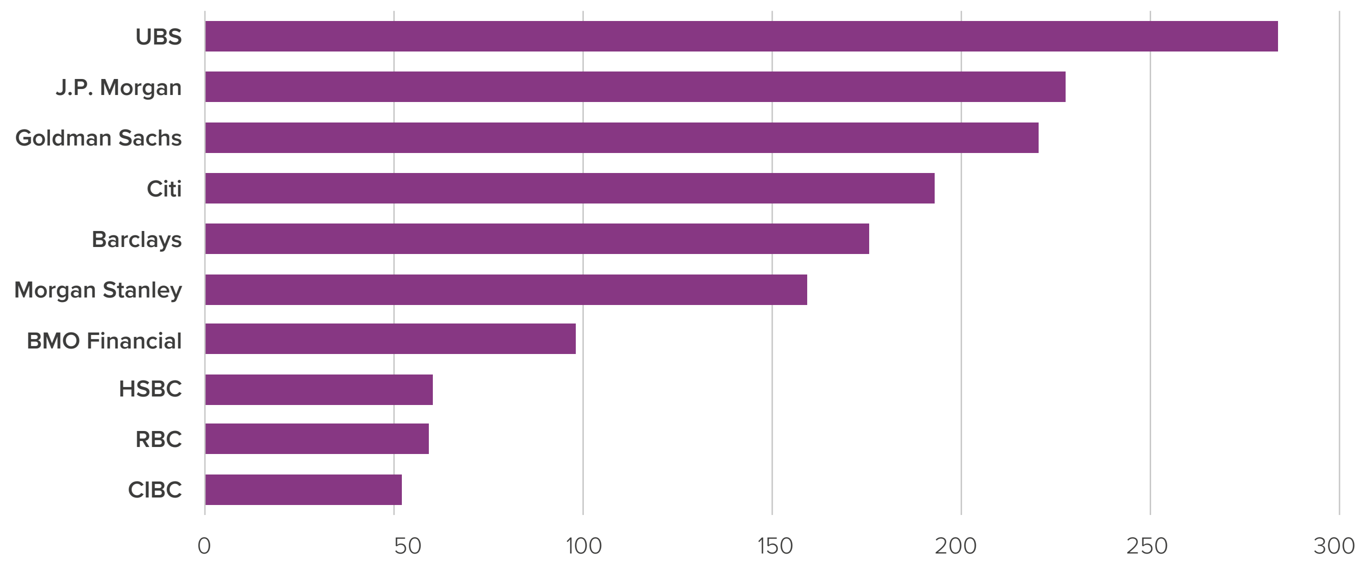
HSBC Bank achieved sales of US$1.7m with its Buffered Accelerated Market Participation Securities 40438C6V8 on the S&P 500 ESG Index in the US. At maturity, if the index has not fallen below 90% of its strike price, the note offers 200% in the rise, capped at 11.15%. The minimum capital return in that case is 100%. The estimated initial value on the pricing date is expected to be between US$850 and US$950.

Also in the US, **UBS Financial Services** sold US$3.4m worth of Trigger Gears on a weighted basket comprising Eurostoxx 50 (40%), FTSE 100 (17.5%), Nikkei 225 (25%), Swiss Market Index (SMI) (10%) and S&P/ASX 200 Index (7.50%). At maturity, the product offers an enhanced participation of 261% in the basket, providing it has not fallen below 70% of its starting level. Scotiabank is the issuer and an underwriting discount of US$0.5 applies. The initial estimated value was set at US$8.946.

LATIN AMERICA

Scotiabank Inverlat collected MXN54.6m (US$2.72m) with an American warrant on the share of Delta Air Lines in Mexico. The product has a one-year maturity but can be redeemed early (quarterly) if the share closes at or above its

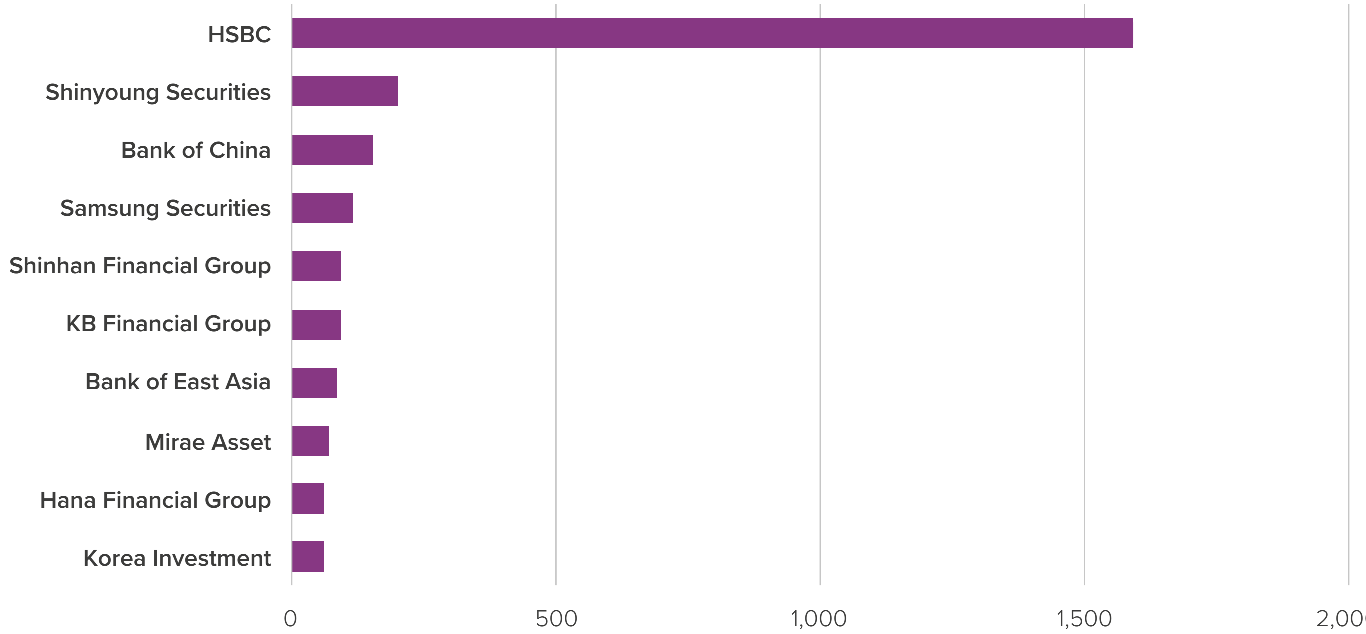
Americas: top 10 issuer group by issuance - 16 May to 12 June 2021*



*Excluding flow- and leverage products

Source: StructuredRetailProducts.com

Asia Pacific: top 10 issuer group by issuance - 16 May to 12 June 2021*



*Excluding flow- and leverage products

Source: StructuredRetailProducts.com

initial level on the valuation date. In that case a coupon of 5.6% per quarter elapsed is paid.

MIDDLE EAST & AFRICA

Glacier Financial Solutions launched Sustainable World Enhancer May 2021 in South Africa. The five-year product is set up in a sinking fund policy underwritten by Sanlam Life. It is fully capital protected at maturity and offers 400% participation in the upside performance of the Solactive Sustainable Development Goals World RC 8 EUR Index. All fees, including the intermediary's initial fee of up to three percent, are priced into the product.

ASIA PACIFIC

Sumitomo Mitsui Trust Bank accumulated sales of JPY8.35 billion (US$76.4m) with unlisted registered note M20260603 in Japan. The five-year product offers a fixed coupon of 1.5% for the first quarter. Every quarter thereafter, it offers a coupon of the same amount if both the Nikkei 225 and Eurostoxx 50 close at or above 85% of their initial levels on any valuation date, or a coupon of 0.1% pa otherwise. The product has an autocall feature which is triggered if both indices close at or above 105% of their strike price on the valuation date.

HSBC Bank issued the Canadian dollar denominated Target Rate Investment FK1133 in Hong Kong SAR. The six-month structure is linked to the appreciation of the US dollar relative to the Canadian dollar. At maturity it returns 100.17% of the principal amount if USD/CAD is at or above the trigger Rate, which is set as USD/CAD spot +0.0200. Otherwise, it returns 100.12%.

Shinhan Bank is targeting WM safe SPECFRKH Upward ELD 21-9 at investors in South Korea. The two-year deposit participates 45% in the upside performance of the S&P Economic Cycle Factor Rotator KRW Hedged Index, which seeks to rotate its investment strategy across four strategies based on the most recent economic data from the Chicago Fed National Activity Index, with a target volatility of six percent while hedging for South Korean won currency risk.

People Moves

BofA's global EQD head resigns, new investment bank chief announced

Bank of America's (BofA) global head of equity derivatives, and equity client solutions, in New York, **Cyrille Walter**, has left the US bank, SRP has learned.

Walter was a colleague of Fabrizio Gallo, co-head of global equities and Emea global markets at BofA, who left the bank at the end of 2020. Gallo had been demoted amid allegations he had not been sympathetic to staff's concerns and requests to work from home at the beginning of the Covid-19 pandemic.

Gallo's departure was announced in November 2020 by the bank's head of global banking and markets, Tom Montag, alongside the appointment of Soofian Zuberi as sole head of global equities. He had been promoted a few months earlier to co-head the division that houses the bank's equity-linked derivatives and structured products business alongside Gallo.

As sole head of the equities unit, Zuberi reports to Jim DeMare who was also appointed head of global markets, a newly-created role, in August 2020. DeMare was previously co-head of global fixed income currencies and commodities (FICC) trading, alongside Bernard Mensah.

Walter was BofA's global head of equity derivatives, and equity client solutions, since 2019. He had assumed additional responsibilities as head of Emea trading in 2016 after a reshuffle of the bank's global equities senior management and continued to run client solutions and structuring globally, reporting to Gallo. In this role, he worked closely with Zuberi, and regional leaders on product distribution.

Earlier, in 2014, Walter was put in charge of the BofA client solutions group, which houses the bank's structured financing businesses in addition to broader derivatives activities, after the bank reorganised its global equities division which saw the business aligned under three functional product groups (including execution services, client solutions and asset management services).

Walter joined BofA in 2011 as global head of equity derivatives and European head of equities, from Morgan Stanley in London, where he was head of European equity trading.

Walter was part of a group of Morgan Stanley equity derivatives executives including Michel Sindelar, an executive director in stock trading based in New York, that joined BofA, who shifted to BofA to work for Gallo.

Sindelar, whose latest role at BofA was head of equities sales, Emea and Emea distribution, parted ways with the bank in late 2018. Sindelar joined Baml from Morgan Stanley, where he was an executive director in stock trading in New York, since 2000. Sindelar's departure followed the bank's decision to move its equity derivatives team to Paris in preparation for Brexit.

INVESTMENT BANKING

The US bank has also announced internally the appointment of **Thomas Sheehan** as sole head of its investment banking business.

Sheehan has co-headed BofA's investment banking division over the last two years alongside Jack MacDonald who has resigned from his position. Sheehan joined the bank in 2014 as co-head of global healthcare investment banking and was given full responsibility of that team in 2015.

'With more than 25 years of banking experience, Thomas possesses the ideal mix of relationship management and leadership skills to continue to relentlessly drive our business forward, capitalize on opportunities and deliver growth,' said Matthew Koder, head of corporate and investment banking, in a memo.

According to Koder, Sheehan was 'instrumental in helping' BofA achieve 'its best year ever in 2020 in terms of investment banking fees resulting in US$7.4 billion of revenue, as well as record fees of US$2.3 billion in the first quarter this year'.

Sheehan will continue to be based in New York City and report to Koder.

The US bank rebuilt its Emea equity derivatives team over the summer of 2018, following a number of senior departures. In 2019, the bank dropped Merrill Lynch from its investment banking brand, while keeping the name Merrill for wealth management, a move to boost morale in its investment bank after a year of declining market share and revenue.

BofA's structured products sales have been on a steady decline since 2019 after a 25% fall year on year at the end of 2020. In Q1 2021, the bank's sales of structured products remained subdued at US$857m (187 products) despite almost doubling its structured product issuance compared with the same period a year prior (US$764m/92 products).

CAT Financial

David Schmid, former head of investment solutions and member of the executive committee at Leonteq, has joined CAT Financial Group as a strategic partner and co-owner.

Effective 1 June, Schmid (pictured) will join the Swiss firm to drive the expansion of CAT Financial in Switzerland with a particular focus on growing outside its core market. He will also contribute to the further growth of the business activities of the CAT Financial Group.

The firm has just opened new offices in Zurich and has announced plans to open its fourth Swiss branch in Geneva in the autumn of 2021.

CAT Financial Products is one of the leading providers of investment solutions in the structured products sector in Switzerland - David Schmid

In addition, Schmid will be responsible for the strategic development of CAT Financial Products, the firm's structured products subsidiary including the internationalisation of activities in structured investment solutions. The firm is also seeking to capitalise on Schmidt's 'investment expertise and international network, to expand existing direct investments in SMEs as well as asset management for private and institutional clients in a targeted manner'.

The expansion of the firm's business activities to offer new services is also being considered to achieve the group's ambitious growth targets, said Giuliano Glocker, founder and partner of the CAT Financial Group.

'CAT Financial Products is one of the leading providers of investment solutions in the structured products sector in Switzerland,' said Schmid. 'We also want to strengthen this position outside our home market, and (…) expand our range of products and services.'

Schmid worked for Leonteq in Switzerland since 2013 - he was head of structured solutions South East Asia and co-head structured solutions Switzerland at EFG Financial Products since 2008 before the firm was rebranded as Leonteq in 2013.

Schmid was appointed to Leonteq's executive committee in 2016, after two years as head of structured solutions Asia and CEO Asia, in Singapore, where he looked after Leonteq's business activities in Hong Kong, Singapore and Japan for four years. He was a driving force behind the launch the firm's manufacturing and distribution of financial products in the Apac region before heading up global distribution and trading of structured products in Zurich. Prior to joining EFG Financial Products, Schmidt spent two years in project management at UBS.

The CAT Financial Group currently comprises three business units: CAT Financial Products offers structured investment solutions for asset managers, banks and institutional investors using the most innovative technologies; CAT Growth enables investors to invest directly in SMEs; and CAT Wealth Management, which is dedicated to private and institutional asset management.

The Swiss group recently launched Arx Financial Engineering, a Dubai-based brokerage subsidiary offering structured derivative solutions and structured products (flow and non-flow), fixed income and alternative financing focused on institutional and professional clients from Russia/CIS, emerging markets - predominantly the Cooperation Council for the Arab States of the Gulf, Asia/Singapore and non-US.

BNP Paribas

BNP Paribas has promoted **Stephane Ritz** to head of global markets Asia Pacific, effective June. In addition, **Brian McCappin** has been appointed head of global markets institutional sales for the region.

Ritz, a 26-year veteran of BNP Paribas, has held a variety of senior trading and management roles in Hong Kong, Japan, Paris and London. He will succeed Pascal Fischer and report to the bank's global markets head Olivier Osty. Fischer will take up a new undisclosed role with the bank in June and relocate to Europe.

In his new role as global markets head of institutional sales Asia Pacific, McCappin will oversee commercial strategy and sales efforts across a range of institutional clients and global business lines. He will be responsible for growing the global financial institutions segment across the 13 markets where the bank operates, 'working closely with the regional institutional sales managers in Europe and the Americas'. He reports to Talbot Stark, BNP Paribas' global head of institutional sales.

McCappin joins from Citibank in New York where most recently he ran the global FX institutional sales team. During his 25 years with Citi, he held a number of senior sales and trading roles including head of global markets in Japan and chief operating officer for global markets Asia, before relocating to New York in 2012.

The appointments follow the recent launch of the bank's new global banking division in Asia Pacific, to bring the structure of its business in the region in line with its international operations.

Credit Suisse

Credit Suisse has promoted **Alois Müller** to head of private & alternative markets Apac, a newly created role in Hong Kong SAR.

In his expanded duty, Müller will report regionally to François Monnet, head of private banking North Asia and Benjamin Cavalli (right), head of private banking South Asia. He will retain the current responsibilities as head of global private equity and continue to functionally report to Fabian Shey, head of investment solutions & products (IS&P) private & alternative markets.

Prior to joining Credit Suisse, Müller spent nearly 17 years at UBS with a stint in Hong Kong SAR building UHNW business in onshore wealth management locations in China, Taiwan, Japan, Australia and India. In 2016, he launched Starstreet Partners to service wealth families, entrepreneurs, and financial institutions in Hong Kong SAR.

Raffles Family Office

Julien Grunebaum (left) has joined Raffles Family Office as an investment solutions advisor.

Grunebaum joins from Leonteq where he was tasked with the distribution of cross-asset structured investment solutions to external asset managers (EAMs) and family offices. Based in Hong Kong, he is responsible for the multi-family office's structured investment solutions across the group.

"Julien will drive internal distribution and strengthen the group's investment capabilities, particularly in bespoke cross-asset investment solutions, across both discretionary and advisory strategies," a spokesperson told SRP.

He reports to Ray Tam, managing partner of Raffles Family Office, in Hong Kong SAR.

Grunebaum started his banking career at Leonteq in 2017 in cross-asset structured products sales trading in Monaco, and moved to Hong Kong to join the firm's structured products & investment solutions team. Prior to that he was a fixed income sales at Unicredit in France.

SG

Antonio Celeste (pictured) joined SG's asset management subsidiary as an ESG product specialist in its ETF and indexing division from French smart beta ETF issuer Ossiam in November 2020.

In his new role, Celeste will be in charge of the team responsible for innovation and promotion of the firm's ESG ETF range.

At Ossiam, he was head of business development and ESG for two years from 2018. Prior to this, he spent seven years as managing director for the Emea region at Sustainalytics where he directed business development and sales in Europe and managed operations in France, with a focus on institutional investors.

He played an integral part in developing the ESG Signals product and Sustainalytics' brand in Europe, as well as in establishing research partnerships with brokers. He has also held roles as head of business development at Vigeo Eiris and BearingPoint.

The French asset manager made a number of appointments to its ETF team including Hirosuke Uraoka as head of ETFs for Japan in October and Freddie Pendarves who joined the firm's UK sales team in August.

As reported by SRP, Société Générale will retain €16 billion worth of structured products of Lyxor's assets under management as the negotiation with Amundi to dispose of the bank's asset management activities operated by Lyxor does not include these products. The French bank will also create a wealth and investment solutions team within its private bank to sell structured products and asset management solutions.

Valuations: navigating market conditions and portfolio management

Independent valuations can enable distributors and investors to connect the start and end points of structured products.

Because of the way products are created, the role of valuations and the existence of a functioning secondary market are critical. As far as investors are concerned only the two ends of the investment are known. The initial issue price (usually par) defines the product and allows comparison with other offerings in the market and investment types.

Investors naturally expect regular valuations of structured products during their lifetime to connect these start and end points. This serves two main functions: portfolio reporting and reacting to market conditions if an early sale becomes desirable.

Most structured products tend to be held to maturity, and this is generally the right course of action for investors to benefit from the defined returns. However secondary market dealing is almost always offered by investment banks and this is important to allow early sale either for an investor's own reasons, to take profits or to reposition a portfolio. A secondary market also boosts confidence in the sector. It is still almost universally the case that sale is only allowed back to the issuing investment bank rather than on the open market, this development has yet to become mainstream.

During the lifetime of a structured product an investment bank will provide regular valuations to its investor base. These should reflect the total market value of the instruments while also taking the bank's funding position into account.

However, this process does vary in its effectiveness. Some banks will seek to keep prices within a bid-offer that spans the fair value, however at other times prices can be quite low because of funding implications, lack of appetite for dealing or slow updates applied to price feeds.

GOOD GOVERNANCE

To ensure good governance around the structured products that they have placed and to reduce reliance on the banks a third party is often engaged to provide independent valuations on a regular basis by distributors, buy-side firms or fund administrators.

The two most common valuation frequencies are daily for regular trading and fund or portfolio reporting purposes or monthly for an auditing-based approach. While some buy-side firms have the capacity to perform such duties in-house they can still prefer the independence and arm's length approach of a third party as it provides stronger regulatory comfort of a robust governance process.

Valuing structured products requires a flexible model suite and accurate market data. For equity products the main choices are Black Scholes for simple European structures linked to one underlying, through to local and stochastic volatility models to handle multi asset and correlation regimes and the creation of volatility skew and smile surfaces.

A knowledge of market practice is important to understand how trading desks make reserves for particular risk points such as barriers, autocall points and digital events. Deriving volatility, dividends and correlation pricing curves is a process done at least daily considering traded options, certificates and other pricing feeds and sources.

It is well known that different banks can have varying risk appetites and views of the market at times with the result that they can quote prices significantly apart. This is particularly true for more complex or long dated products. Once a product is in its lifetime, these differences can become larger due to the sensitivity of products to different situations such as approaching a barrier or auto-call date.

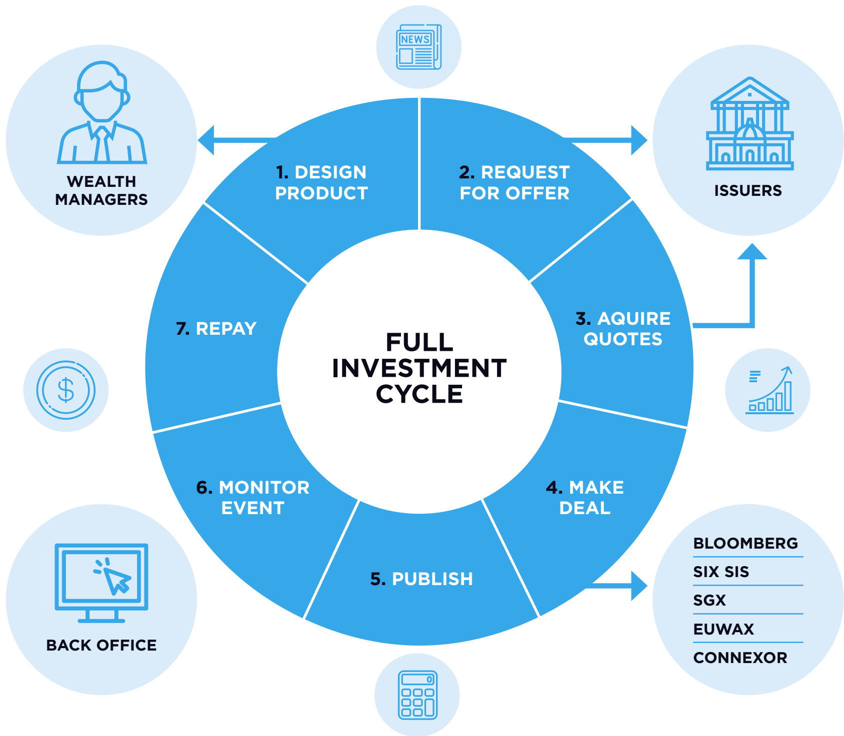
A formal price difference tolerance (of up to 5%) is generally agreed so that price differences in excess of this level are properly investigated. In practice differences are closely monitored before a full breach occurs and under such circumstances it is important to understand where the variance is coming from. Typical causes are differences in pricing curves, risk buffers and the bank's current pricing policy. Giving buy-side clients confidence in the reconciliation process means that they can rely on a valuation service being fit for purpose for their business obligations.

SRP NEW LIFE CYCLE MANAGEMENT PORTAL

SRP has entered into a joint venture with FVC to design a "lifecycle management" portal with a "single sign-on", to be powered by SRP database. Technical specifications allowing eligible SRP subscribers to access the portal with their existing SRP access credentials to be announced during the SRP Americas event in September.

The purpose of the life-cycling portal is to provide a complete structured product selection, monitoring and analysis system. The portal will have different use cases depending on client and jurisdiction. Its primary function is as a fully featured structured product management tool for advisers, brokers and smaller buy-side firms such as discretionary fund managers and family offices.

Initially the valuation service will cover live products on the US database across the most popular payoff types such as Autocall, Reverse Convertible, Leveraged Upside, Participation, Digital and Twin Win across a large selection of underlyings, issuers and maturities covering thousands of live products. This new valuation service will then be rolled out to other markets globally in 2022.



KEY BENEFITS OF THE LIFE CYCLE MANAGEMENT PORTAL INCLUDE:

- ✓ Direct structured product governance tool for financial advisers and brokers. Typically, there are three layers to usage for a medium to large company – firm wide compliance, by adviser and by individual end client.
- ✓ Dynamic product reports: Reports for each individual structured product in the universe will be updated and produced on a regular basis (at least weekly). These will be based on the successful adviser facing Structured Edge report concept that has been used by thousands of advisers in the UK for the last twenty years. **And more...**

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