Risk Awards 2010

STRUCTURED PRODUCTS HOUSE OF THE YEAR BARCLAYS CAPITAL

The structured products business was hit hard by the crisis, with demand all but evaporating in the months following the failure of Lehman Brothers in September 2008. Lehman had been a major issuer of structured notes, and its demise underscored to investors – in many cases for the first time – that buying a note meant they were exposed to the counterparty credit of the issuing bank. At the same time, a major drop in equity markets and spike in correlation and volatility left investors nursing huge losses on popular equity-linked structured products.

Despite this, the structured products market partly recovered in 2009, albeit in a slightly different form from pre-crisis. In the current environment, the best dealers have been those that have adapted to market conditions, created products with relatively simple payouts, allowed investors to access asset classes beyond equity, and responded to client concerns about counterparty risk.

Barclays Capital ticks all these boxes. On top of that, the acquisition of Lehman's North American capital markets and investment banking operations meant it was able to broaden its footprint in the US and Asia.

"Barclays Capital's approach has been one of consistency across execution, innovation and service. In a year that saw overall issuance volumes for the global market approximately 25% down on the previous year, some consolidation and challenging market conditions, we were actually able to have our most successful year," says Philippe El-Asmar, global head of the investor solutions team at Barclays Capital in New York.

The investor solutions team now numbers 200 structurers and 150 sales staff globally, covering equities, credit, commodities, interest rates, inflation, foreign exchange, hedge funds and emerging markets. The single team has allowed the bank to react seamlessly to opportunities as they arise across asset classes, says El-Asmar, something he believes differentiates the bank from many of its competitors, which operate their business on an asset class by asset class basis.

Many of the clients who spoke to *Risk* pointed to this cross-asset capability, as well as its idea generation and competitive pricing. "Barclays Capital has been a strong counterparty in structured products over the past year and one of our main contacts. They often won our trades by offering good prices and strong research, particularly in currency-linked products," says Ed Burrill, relationship manager in the multi-asset structured products advisory practice at Schroders Private Banking in London.

"Barclays Capital has been a very pleasant surprise, and we didn't realise quite how good they were, whether it is in plain vanilla structured notes, precious metals or emerging market currencies," adds a senior foreign exchange and commodities specialist in the private banking arm of a major US bank.

That's not to say Barclays Capital was immune to the problems that ravaged the structured products market in the fourth quarter of 2008 and into 2009. The investor solutions team experienced one of its toughest ever periods as demand from investors dried up.

"Two key things happened after the Lehman default: one was the questioning of the very existence of structured investments; and the other was investor concern over where to put their money and what made sense in those market conditions. As all asset classes were very heavily correlated in that period, we saw investors move to the sidelines and keep their money in cash rather than structured products," says El-Asmar.

Those that remained in the structured products market were keen to minimise counterparty risk – a fear that sparked increased focus on exchange-traded products, as well as notes issued by fully collateralised special purpose vehicles. Investors also preferred short-dated investments and simplicity.

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Two markets bucked the trend of falling demand: the UK and Japan. El-Asmar attributes the continued interest in lightly structured investment products to record low interest rates, which encouraged investors to look for alternatives. "UK rates were historically not as low as in the US and elsewhere, but as they started going down during 2008, investors sitting on cash deposits or very simple fixed-income instruments started looking for alternative ways of earning returns," he explains.

Catering to this demand, Barclays Capital launched two interest rate-linked products for retail investors that protected them from rates decreases while allowing them to benefit from increases. One product, dubbed the sticky floater, was a five-year capital protected floating-rate note that paid a minimum coupon of 3% semi-annually and locked in interest rate increases for the life of the note. The other, called the floored floater, was essentially the same, but gave investors the safety net of a minimum return linked to Libor.

Having first launched the products in May 2009, Barclays Capital had issued more than €2.15 billion of floored floaters and sticky notes in Germany, Switzerland and Italy by the end of the year, as well as £50 million in the UK and $500 million in Japan. Not only were investors attracted by the simple and short-dated nature of the products, but they were also drawn to the fact they were listed on an exchange, at a time when customers were generally seeking greater transparency in structured products, says Uwe Becker, Frankfurt-based head of investor solutions in Europe.

"Heightened demand for transparency and after-sales services of structured products led to a strong increase in the listed investment products markets. The floored and sticky floater notes benefited from being listed on-exchange, with the associated simplicity, transparency and liquidity," he says.

Japan was another highlight for Barclays Capital, in a year when the rest of Asia saw a greater decline in new issuance of structured products than either Europe or the Americas. "We have focused attention in Japan on serving clients across asset classes to build more of a flow business around structured investments, rather than focusing on large fund-linked trades. We have seen particular success in Japan with flow equity derivatives, simple structured foreign exchange products, emerging market cash and structured trades, and also simple rates products," says El-Asmar.

If the UK and Japan were the bright spots in Europe and Asia, then the highlight of its activity in the Americas was the acquisition of the Lehman Brothers business in North America. For the investor solutions team, Lehman's strengths in equity derivatives trading and distribution of structured rates products to retail investors were a great fillip to Barclays Capital.

"Prior to the integration, Lehman Brothers was ranked higher than Barclays Capital in most surveys when it came to the distribution of rates products to retail clients. While we were strong in equities, commodities, foreign exchange and emerging markets, we never had the dedicated focus on structured rates for retail clients. And the equity trading capabilities from Lehman Brothers enabled us to build out our structured products business to more complex products," says El-Asmar.

On the equity side, the most visible result of the acquisition of Lehman Brothers in the US has been the launch of a new breed of exchange-traded notes (ETNs) referencing the Chicago Board Options Exchange's Vix index. ETNs are senior unsecured debt securities that track a specified index and are backed by the credit of the issuer. Having pioneered the ETN market with the launch of the first product back in 2006, Barclays last year broke new ground by becoming the first dealer to launch a volatility ETN.

The idea of creating ETNs linked to volatility began even before the acquisition of Lehman Brothers, with Barclays Capital keen to launch a listed volatility product in the US. In early 2008, the investor solutions team identified Lehman Brothers as a potential partner because of its strengths in trading Vix futures.

"We signed a non-disclosure agreement with the intent of working together. Barclays Capital would be the issuer and Lehman Brothers would provide us with a hedge. The first thing we did when we moved into the new building in late 2008 was to reach out to those people we had made contact with six months earlier and start preparing the launch. Neither firm could ever have done it on their own because they didn't have the right combination of trading and distribution skills, so really it was the perfect integration," says El-Asmar.

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The launch of the iPath S&P 500 Vix Futures ETN finally materialised in January 2009. The first product, known by the ticker symbol VXX, is linked to the shorter-end of the volatility curve and acts as a trading instrument, while the VXZ is linked to the three- to six-month part of the curve, offering investors more of a buy-and-hold instrument to express a longer-term view on volatility. Most of the volume in 2009 was traded on the shorter-dated VXX, with the combined assets under management of the two products reaching $725 million by the end of the year.

Distributors say the product has been a big success, particularly with institutional investors that may not have had the expertise to trade volatility futures in the past but wanted access to volatility in a transparent, exchange-traded instrument. "For many years, a lot of our clients wanted to take a view on volatility either as a short-term trading instrument or a longer-term product. Launching a volatility ETN under the iPath umbrella gave investors the transparency and secondary market liquidity that was so important to them and was completely unique in the market," says Noel Archard, San Francisco-based managing director at iShares, an exchange-traded fund provider acquired by BlackRock in December 2009. ■