

Structured Products Association's Keith Styracula sees industry rebound after a tough year

By Emma Trincal

New York, Nov. 6 – Prospect News interviewed Keith Styracula, chairman of the Structured Products Association a week before SPA's Fifth Annual Autumn Expo.

During this conversation, Styracula reflected on one of the toughest years in Wall Street history and examined some of the new regulatory challenges faced by the industry.

But his outlook for the structured products market was optimistic. A year after the Lehman Brothers' bankruptcy, the industry is booming in a way that resembles the "post-dot.com phenomenon."

Prospect News: What will be the main focus of this year's discussions?

Keith Styracula: Well the first overriding factor is: where are we as an industry now one year after Lehman? The industry has changed dramatically in terms of consolidation. We've seen many independent structured products players – one-time independent players – teaming up, such as Wachovia-Wells Fargo; Merrill Lynch-Bank of America.

We've seen some firms actually exit, such as Macquarie, Calyon and Rabobank.

Now what's interesting is that [while] there is a contraction of issuers – which we anticipated, not quite to this dramatic effect or because of this type of reason, but we knew that there was going to be consolidation of issuers – the distribution channels are

starting to grow really dramatically.

And so now we're seeing investment advisers coming into it.

And this is not inconsistent with what we saw post-dot.com phenomenon. Post-dot.com phenomenon, after indexes lost 40% of their value and the money markets were paying less than 1% to save money, there was an uptick of structured products to demonstrate to retail investors, high-net-worth, corporates and RIAs [Registered Investment Advisors] that they could repair portfolios with moderate leverage, they could protect principal and they could throw off above-market yields in certain strategies.

That's what caused the structured products industry to boom from 2000 till the Lehman [crisis].

Prospect News: Is there a way for investors interested in structured products to identify who the experienced financial advisers are?

Keith Styracula: We found that the wirehouses have set up a dramatically effective program for making financial advisers aware of the benefits of structured products.

For example, my understanding is that Merrill Lynch has 50% penetration of its brokers being able to sell structured products or structured investments to Merrill Lynch clients. I understand that Merrill Lynch had very good numbers and some deals have reached more than \$300 million. They're hitting the century mark. Oscar Loynaz and his team are just doing a great job over there.

What we're seeing again is that, after a perilous year of declines in market indexes, investing in structured products is one of the best ways to

get your portfolio back in shape.

ETN resurgence

Prospect News: Could you talk to us about regulatory changes pushed by the Commodity Futures Trading Commission and how the new position limits could have consequences in the exchange-traded notes market?

Keith Styracula: The credit crisis is not completely behind us. Not quite yet. We saw CIT just declaring bankruptcy. For structured products, there is still a lot of concerns about the creditworthiness of counterparties.

But that eventually will be alleviated when the market stabilizes, when the credit market comes back. And then what you'll see is a resurgence of ETNs, exchanged-traded notes.

Right now it's still in its infancy and it had a setback with Lehman Brothers. But exchange-traded notes are going to be a \$50 to \$75 billion opportunity in the next two years. Right now it's only less than \$10 billion.

One of the most popular ways to get exposure to commodities is through exchange-traded notes. So the mutual fund industry has made a big deal about the credit risk of exchange-traded notes because Lehman Brothers had a few ETNs that failed.

But what's not really said is that [ETNs] have instant liquidity on the exchanges. If there's ever credit concern, all investors in ETNs, much like ETFs, can just liquidate in the secondary market.

In that regard, we think that the credit concerns have been greatly exaggerated. ETNs are an excellent vehicle for providing exposure to commodity indices.

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We saw UBS just came out with a brand new Exchange-Traded-Notes linked to the Dow Jones-UBS Commodities Index. They have high hopes for that. And it continues to be the most cost-effective way to get exposure to that asset.

'A reasonable middle ground'

The CFTC is expressing some concerns – which are completely understandable – that you can create too much one-sided market risk.

But it's SPA's position that the CFTC shouldn't simply put a blanket position limit on speculative limits. They should consider netting off the exposures on a firm-by-firm basis much like they do on the commodities futures market. Whatever your net long or short position is the appropriate measure of the risk to the market. I think right now it's a very fluid thing. I think they're floating a lot of trial balloons to try to get a sense and to see how people respond to it. And I think that it's a reasonable position they'll arrive at eventually.

But it's very disruptive to the market to compel Deutsche Bank to unwind its two-times oil exposure.

And by the way these unwinds have market disruption capabilities. And I think we saw a lot of front running on the Deutsche Bank unwinds of their two-times oil ETFs.

So it has to be done in an orderly and well thought out process. I empathize with the CFTC's concerns. But I think there needs to be a reasonable middle ground.

Prospect News: How about what's happening with OTC derivatives regulation. Will that eventually impact the structured product market?

Keith Styracula: We think so. We

think that it can have an impact on the structured product market because there will be more cost to hedge over-the-counter derivatives transactions when they put up centralized counterparties or CCPs.

So there will be higher margin requirements and what have you, which is unclear to us yet as it's still a moving target.

Would a structured product that is hedged with a privately negotiated transaction that's just within the same firm, does this need to be put on an exchange? Reasonable minds differ as to whether it's going to be the case. If so, then there'll be enhanced cost for structured products that would be passed on to end investors.

Right now, what people typically do is that the New York branch enters into an arms-length transaction with a London branch. And the London branch goes and makes decision on whether it's going to hedge in the market or just take a speculative view on the position. And so it's all within the firm.

So my point would be that if there is an exemption that's being carved out for the corporates, for their hedging purposes, maybe there should be a similar intra-bank exemption for structured products hedging their own risk to their balance sheet.

Prospect News: Would the regulators be open to that?

Keith Styracula: I think that the

windows are narrowing in terms of those discussions but they're ongoing and our counterparts over at ISDA [International Swaps and Derivatives Association] I think are doing a marvelous job in articulating the industry's position.

And eventually structured products will be mainstream to the point where we'll see the same penetration that you see in a wirehouse like Merrill Lynch.

- Keith Styracula

A secret weapon

Prospect News: Let's talk about some of the issues around marketing and distribution, which will be discussed at the conference.

Keith Styracula: There is a big gold rush right now of firms that are racing toward the Registered Investment Advisor community, the RIA community. They believe that these are the types of financial intermediaries who will take the time to get smart about structured products, structured investments and find unique ways in using it in their clients' portfolio.

RIAs that are active in the SPA consistently say that it's their secret weapon. It sets them apart from every quote-unquote stock picker or portfolio diversification guy.

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We see right now the penetration rate in the RIA community is a little bit north of 10%.

The best 10% of the RIA community gets it. We'd like to see that number move to 25%.

And eventually structured products will be mainstream to the point where we'll see the same penetration that you see in a wirehouse like Merrill Lynch.

Broker certification?

Prospect News: Does the SPA keep any registry of those 10% advisers who understand structured products well? Are you considering special training for advisers?

Keith Styracula: Well, great question. One thing we've been talking about and discussing at the conference so that we can get a broad industry consensus is, do we need some sort of SPA certification of brokers that would set them apart?

Should the SPA be in the business of aggregating the names of RIAs that are interested in structured products so that they can be approached by the industry?

The difficulty with the RIA community is that it's so disparate. There's no central hub. Maybe the clearing firms are ways of gaining access to RIAs but right now it's the great untapped.

The SPA is going to be teaming up with some of the RIA industry groups to make those presentations.

At the conference, we'll have a presentation with the Investment Management Consultants Association. So we'll be speaking in November before 500 RIAs. And we're looking aggressively for those types of opportunities. Eventually we hope that SPA can host the RIAs at a conference.

Index innovation

Prospect News: Let's talk about

indexing, another conference topic.

Keith Styracula: The big buzz word right now is innovating indexes, many of which have been devised by the structured products firms themselves, for instance the Société Générale WISE index. They teamed up with Wells Fargo to offer a principal protected version of that.

We know that Royal Bank of Scotland is rolling out some interesting indexes.

We see the same with BNP Paribas with its own new long/sort indexes. And JP Morgan with its dynamic indexing has created a real buzz. Both JP Morgan and Goldman Sachs are also rolling out new products.

Prospect News: What about Barclays?

Keith Styracula: With Barclays, it's the generation 2.0 on their market-leading commodities strategies. Barclays was the first in the market with what was once the Dow Jones-AIG Commodity index and the Goldman Sachs Commodities index. And they were able to attract billions in assets under management immediately with that.

So now what they've been doing now that we've seen a down-drop [in] the commodities, [is asking, is] there a better mousetrap. I think some of the new indexes are a reflection of that. We ought to explore that at the conference.

Prospect News: One of your big conference themes is the convergence of funds and structured products. What about it?

Keith Styracula: In the market down drop after Lehman's demise and when capital became very scarce for the firms, one of the first lines of business they cut was the hedge

fund structured product business.

The American firms were the first ones out of the business because they wanted to retain the capital, the net capital for calculation purposes when capital became scarce. So now I think they're dipping their toes back in the water.

Trevor Randolph was just hired over at Credit Suisse to turbo charge this business. He will be speaking at our conference.

We think that ads a lot of opportunities as hedge funds start to get eye-popping returns. Structured products are an excellent way for family offices to gain tax-efficient exposure to hedge funds.

Prospect News: What are your projects to expand the structured products business and how do you define the mission of your organization? Is the SPA a lobby group?

Keith Styracula: We think the most effective way for the SPA to make headway with the industry is to have an open line of communication between SPA and ISDA and SIFMA [Securities Industry and Financial Markets Association].

The SPA has the good fortune to be able to move nimbly because of our streamlined structure. We think we can take pride in answering regulatory issues and making our voice heard, the industry's voice heard. We think the SPA had a significant impact on the House version of the OTC derivatives bill.

We're not a lobbying group per say. We provide information as needed particularly to regulators that don't have a working knowledge of derivatives and structured products. And we've become a trusted resource for that.

Prospect News: Thank you very much, Keith.

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