2015

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Structured Products in Asia

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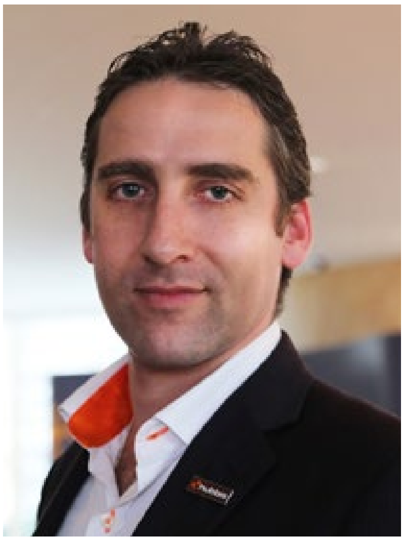

Foreword

This is the inaugural edition of our publication focused on the role and application of structured products within wealth management.

The priority is to educate front-line wealth management staff as part of the broader discussion about how to evolve the structured products space in Asia.

With volatile and uncertain markets likely to continue, practitioners need to understand which products can be sold in decent volume, and then how to have effective conversations with their clients about the role of different products and where they fit in portfolios.

One of the important areas of focus for product providers and distributors today is getting clients to use a broader range of products which are more suitable and relevant to them. Too many clients tend to use the wrong product at the wrong time, and have expectations for specific products in certain market environments which are not necessarily correct. Yet a lot of the time, these clients could use a much simpler structure to more efficiently achieve the aim they have in the first place – and at the same time ensure better returns at lower levels of risk.

Advisers therefore need to know how to assess whether clients should lock in profits and, if so, when and how.

Even as a starting point, wealth managers need to know which range of products makes most sense for them to try to sell – based on which of them are most likely to attract sufficient volume from their specific client base, and therefore are most scalable, rather than focusing on one-off or unnecessarily complex structures to satisfy just one or two clients.

Product manufacturers need to pay attention to what's important to the buy-side: the quality and consistency of their service; the consistency of their pricing; the level of cooperation they are willing to provide when products don't perform as expected; and the ability to provide market colour and investment ideas, as well as a wide range of underlying payoffs and maturities.

On the one hand, this publication covers the business of structured products for gatekeepers on the buy-side. In addition, with client adviser increasingly aware of the need to better understand the products they are selling, the rest of the content aims to achieve this.

I hope you enjoy reading these insights and derive value from them.

ANDREW CROOKE
EDITORIAL AND CONTENT DIRECTOR
HUBBIS

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Feature Articles

J.P.Morgan

Solutions built
on a strong foundation

J.P. Morgan is one of the most established providers of structured products to the Asian region. Working closely with financial intermediaries and local distribution networks, J.P. Morgan meets the needs of a wide variety of investors in the fast growing markets of Hong Kong, Singapore, China, South Korea, Taiwan, Malaysia, and Thailand.

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Expert Insights

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4% to 5%

Structured products account for only 4% to 5% of overall wealth investments in Asia
Page 8

83%

Investors tend to place the most value in investment returns when looking at structured products, according to audience sentiment at a Hubbis event in Singapore
Page 17

400

The number of pay-offs based on the four basic elements of structured products: capital protection, yield enhancement, participation, and leverage
Page 19

30,000

It is estimated there were about 30,000 structured products with a volume of over USD300 billion in Asia Pacific in 2014
Page 26

USD1 bn

Leonteq and Numerix have spent almost USD1 billion over seven years to create the technology behind LAND
Page 43

10%

If a product had a 10% delta and you put USD1 down, if it ended up in the money it would be worth USD10
Page 47

Hubbis content colour coding

REGULATION & COMPLIANCE	SKILLS
INVESTMENTS	STRATEGY & BUSINESS
FAMILY WEALTH	TECHNOLOGY


contineo
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Driving diversification and scalability in structured products

As Asian investors have increased their level of engagement with structured products in 2015, their focus on diversification via some different strategies is healthy for the market.

This year has, overall, been one of the strongest for structured products that many players have seen since 2007.

For the first eight months of 2015, the low interest rate, low volatility environment acted as a tail-wind to force clients to look at different types of products in the market, says Lemuel Lee, head of third party distribution in the equity derivatives group at J.P. Morgan in Asia Pacific. "We have seen a spike in more innovative products."

He says that four categories of product, in particular, have found favour with wealthy individuals which hadn't really been on their radar before.

These include: delta 1 products, to provide access to certain markets and themes; investable indices, to serve as an enhancement to ETFs and passive management; fund derivatives; and innovation around pay-offs, in line with a greater willingness to take more risk.

"There are some products which the bank can create for clients to make more of the volatility yet without risking too much capital."

SEBASTIEN DUPUY
DBS Bank

According to Albert Yuen, managing director and head of product marketing at BOC International, one of the trends he has seen is appetite among investors to get access to specific markets or products.

The diversity in interest is a healthy reflection of investor sophistication as well as their understanding of market expectations, adds Bart Wong, managing director and head of Credit Suisse's custom assets group in the private banking and wealth management group in Asia Pacific.

He sees the market at an interesting juncture – also as a result of the macro-economic and political factors, which can cause major movements.

> **"There has been appetite among investors to get access to specific markets or products."**
>
> **ALBERT YUEN**
> BOC International

While volume is cyclical, some of the risk-diversification strategies in particular have sold in the hundreds of millions, sometimes even billions, of dollars, adds Wong.

"From funds to FX to club deals, diversity is one of the main themes I have seen this year," he explains.

Yuen says fund derivatives are a gateway into certain structures and new asset classes in line with the desire for more diversification.

The uncertainty in relation to interest rates, volatility in emerging markets and currencies, and negative short-term research on equities are among the factors that speakers said make it difficult to know the extent to which markets might move or correct, nor how long changes may last.

In turn, adds Sebastien Dupuy, executive director and product solutions head, private banking/treasures private client, consumer banking group and wealth management, DBS Bank, this creates uncertainty for relationship managers (RMs) and clients to decide which products to focus on.

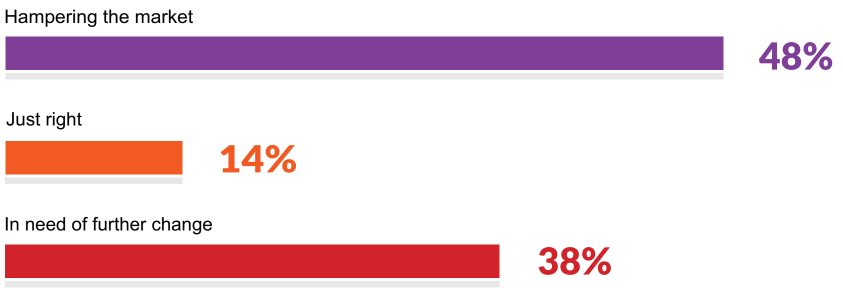
At the same time, he says that there are some products which the bank can create for clients to enable investors to make more of the volatility yet without risking too much capital.

CREATING SCALABILITY

Creating product itself is not the problem for gatekeepers, says Dupuy. "Even if a client wants to take a view on an asset class they otherwise can't really access, then we can use structured products to create a pay-off."

Instead, given the transactional nature of Asian private banking, the challenge is to be able to find the right product at the right time for clients, which suits the particular market sentiment and a distributor's view.

REGULATION OF STRUCTURED PRODUCTS POST-2008 IS...



Source: Hubbis Structured Products Forum 2015 - Hong Kong

> **"The diversity in interest is a healthy reflection of investor sophistication as well as their understanding of market expectations."**
>
> **BART WONG**
> Credit Suisse Private Banking

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Another issue for banks and gatekeepers continues to be trying to find scalable products and structures. These are sought after also because they can lead to more recurring revenue.

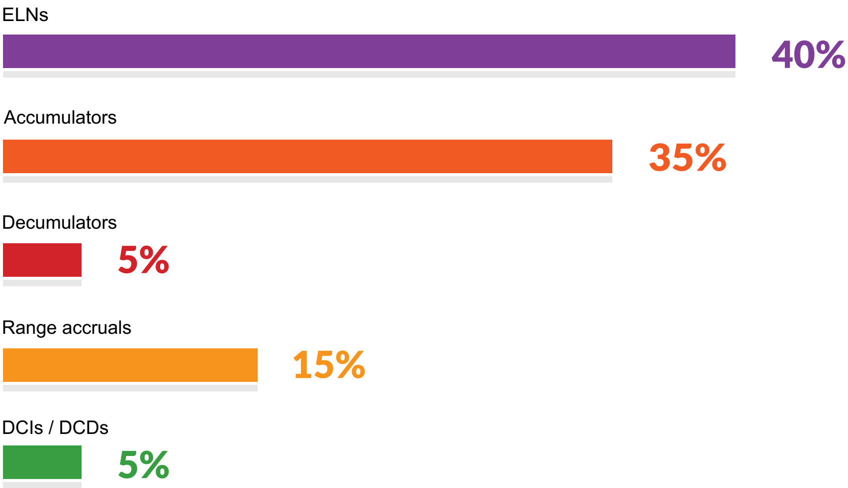
"A lot of private banks face constraints about whether they can book the range of products that exists," says Lee.

Where the real innovation lies, he explains is in offering products as part of a campaign.

"A lot of private banks face constraints about whether they can book the range of products that exists."

LEMUEL LEE
J.P. Morgan

WHICH OF THESE STANDARD PRODUCTS ARE YOUR CLIENTS INTERESTED IN BUYING AT THE MOMENT?



Source: Hubbis Structured Products Forum 2015 - Hong Kong

"Automating the process for standard products leads to a lower cost to distribute."

MARK MUNOZ
Contineo

"To make it worthwhile [for all stakeholders] to sell product, it needs to be recurring," says Lee.

"We need to make sure that it is simple so that it gets understood by investors, and it can then be offered in successive quarters with some changes to the content of the product."

From Yuen's perspective, an area of excitement is the new China Europe International Exchange.

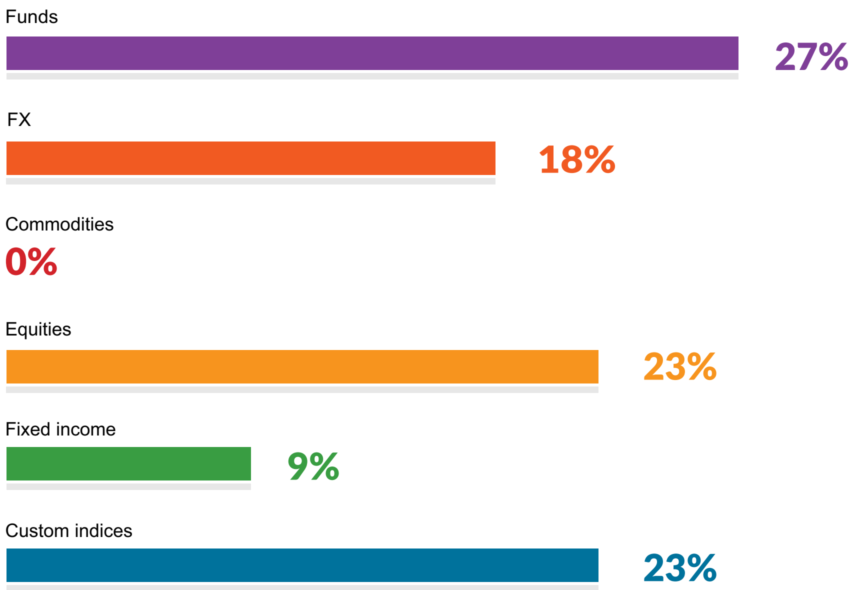
As a joint venture between Deutsche Boerse, the Shanghai Stock Exchange and China Financial Futures Exchange, this first dedicated platform with authorised Chinese investment products outside mainland China will bring the country's capital market directly to international investors.

STANDARDISATION AND TRANSPARENCY ON THE AGENDA

The move towards automation has been another noteworthy trend in the structured products space.

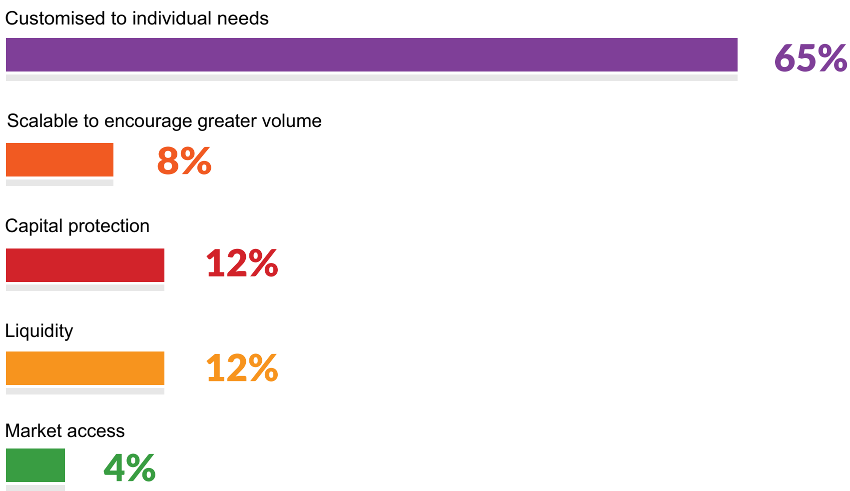
This is also a positive thing as far as standardisation goes.

WHAT UNDERLYING FROM THIS LIST WOULD YOU LIKE TO SEE USED MORE TO ENCOURAGE MORE TAKE-UP FROM YOUR CLIENTS?



Source: Hubbis Structured Products Forum 2015 - Hong Kong

WHICH 1 OF THE FOLLOWING ATTRIBUTES OF A STRUCTURED PRODUCT ARE MOST IMPORTANT TO HELP YOU SELL IT TO YOUR CLIENTS?



Source: Hubbis Structured Products Forum 2015 - Hong Kong

"Automating the process for standard products leads to a lower cost to distribute," says Mark Munoz, managing director of Contineo. "It helps in the process of selling the products to clients in a more effective manner."

The benefits of transparency, too, is something that the regulators like, also as part of the process of streamlining information to reduce the volume of it which is required.

"This is not about creating a simple product in itself," says Munoz. "Instead, it is about creating a set of tools, as well as data and analytics to help automate the business and be more informed about what is happening."

The next step, he adds, is to be able to automate end-to-end, to be more effective for clients, especially if it can lower internal costs.

Wong agrees that cost efficiency is an important component of scalability.

STAYING RELEVANT

The relevance of products is a very sentiment-driven thing, according to the panelists.

For Dupuy, meanwhile, there is little point in offering products like accumulators if banks believe in the concept of managing client money over the long term.

However, finding the 'right' products also comes down to the specific client segment involved.

"If we service UHNW clients, then the more it needs to be customised," says Lee. "We are focused on monetising different parts of the market."

For the mass affluent, where scalability is key, the expectation among those firms which distribute to these investors is to deliver access to product where they get pricing, term sheets and execution in the most efficient way possible. ■

Comparing structured products in Europe and Asia

European and Asian investors have markedly different product preferences, due to shifting wealth patterns, product limitations and cultural traits, explains David Schmid of Leonteq Securities.

Structured product usage in Asia has great potential due to its relatively miniscule usage and the rapid expansion of wealth in the region, but this growth requires much more automation and tailoring of products, according to David Schmid, chief executive for Asia at Leonteq Securities.

Schmid offered a summary of the key differences between the usage of structured products in Asia and Europe.

The key underlying statistic was the growth of overall wealth in Asia, which is expanding at 15% per annum. Asia's overall wealth AUM is expected to grow to surpass Western Europe in 2016, according to a McKinsey study.

"What is remarkable is growth in the number of millionaires in Asia," said Schmid. "In 2009 there were 3 million millionaires, but now there are 4.4 million millionaires. That is a 45% growth rate over five years. Asia is probably the biggest opportunity for structured products in terms of growth."

Structured products account for only 4% to 5% of overall wealth investments, so there is plenty of growth potential.

"In 2009 there were 3 million millionaires, but now there are 4.4 million millionaires. That is a 45% growth rate over five years."

DAVID SCHMID
Leonteq Securities

Presentation Video

http://www.hubbis.com/mainEvent/203_Structured_Products_Forum_-_Singapore/presentations.php?id=220&speaker_id=

RISING VOLUMES

European investors have been placing less money into structured products, particularly in Italy and the UK.

Even so, around USD800 billion is outstanding through 3 million products, many of which are listed retail distribution products.

In total, 75% of the products sold in Europe are equity-linked. In contrast, around 40% of outstanding products in Asia are equity-linked, and a further 50% are FX-linked.

"Other asset classes like credit and commodities are almost non-existent," Schmid observed.

"In my view there is a lack of pre-trade and market analytics. People need to understand risks and de-compose risk of underlying products and transparency."

Asia ex-Japan, meanwhile, has seen its structured product volumes steadily grow from USD700 billion to close to USD800 billion today.

However, the range of products is far smaller in this region, with only around 50,000 products outstanding.

This is mostly because there are very few listed products outside of warrants in Asia, while retail distribution has fallen away since the financial crisis.

Schmid revealed that investors in the latter tend to be very regionally focused on their preferred investments.

"Asian investors tend to invest into Asian markets, but also we have seen recent rallies in Hong Kong. And investors are investing more into Europe too, as it is doing better."

Perhaps most surprising is the diversification of structured products by underlying type.

PRODUCT TYPES

The most popular product types also pointed to some marked differences between Europe and Asia, and in particular the preference for more listed products in the former.

Schmid said that almost 50% of product issues in Europe are in a note format, such as securitisations with certificates.

The OTC market only accounts for 9% of the entire market. "Asia is different; only 30% [of products are] in the securitised format, and about 50% are in deposits, with an OTC format. A lot of investors in Asia like to buy accumulators, which you come across in an OTC format, whether in FX or in equities."

Investors in Europe also take a longer, more investment-themed approach to structured products.

The investment horizon of the products in the continent is typically two to three years, as opposed to Asia, where is it only around six months.

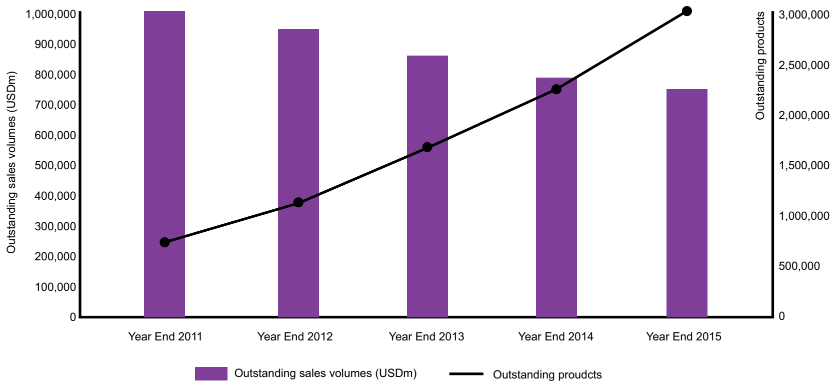
The far broader product range in Europe also comes with many more pay-off structures too; there are around 400 in Europe, versus just a few in Asia, with the likes of accruals, accumulators and equity-linked notes representing 75% of the market. Schmid said the breadth of payout structures in Asia will grow with greater product transparency.

"In my view there is a lack of pre-trade and market analytics. People need to understand risks and decompose risk of underlying products and transparency.

"Increasing regulation since the global financial crisis has reduced the number of products, and rightly so, but there are still worries about the potential for mis-selling, with people cautious after the experience of [Lehman Brothers] minibonds in 2008."

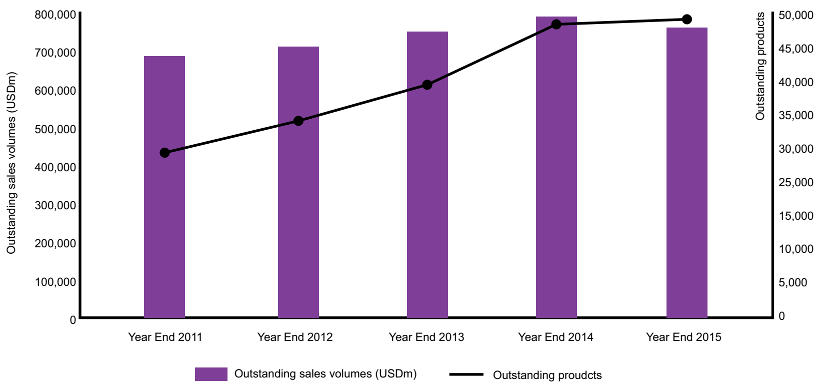
"People do not look at structured products as a black box that they buy and hold until maturity but are starting to look at them in terms of the performance they can lock in while they have the product."

EUROPEAN STRUCTURED PRODUCTS AUM



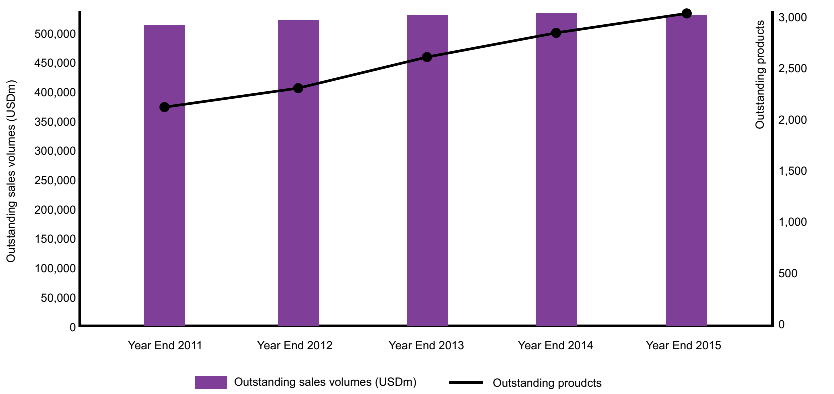
Source: StructuredRetailProducts.com

ASIA PACIFIC STRUCTURED PRODUCTS AUM



Source: StructuredRetailProducts.com

JAPAN STRUCTURED PRODUCTS AUM



Source: StructuredRetailProducts.com

BESPOKE SOLUTIONS

A key to ensure growth is for individuals to better understand the risks associated with structured products, and have the liquidity to trade in and out of them. This is beginning to happen.

"People do not look at structured products as a black box that they buy and hold until maturity but are starting to look at them in terms of the performance they can lock in while they have the product instead of holding it until maturity," said Schmid.

Leonteq is trying to meet this need. Its technology platform allows investment advisers to pick individual stocks or baskets of shares, and structure them with specific derivatives to meet the preferences of the investor.

Schmid believes such automated solutions will help create the ease of use that will encourage more investments into structured products into the future. It will also help the market keep up with the rising trend of more, smaller transactions taking place.

"It's important to have increasing rounds of automation to reduce the workload, and narrow processes need to be automated," he said.

"There are a lot of ongoing platform developments that will let us focus on bespoke solutions.

"Once we can do the majority of flow on platform solutions it will free up some time to create bespoke solutions based on risk-return appetites.

"This will, after all, generate better products, more performance for clients, happier clients, and ultimately more revenue for the distributor." ■

Hubbis at-a-glance

We focus on the Asian wealth management industry and produce high-quality, localised content that is practical and independent. This includes news, articles, research, reports and conference-related content, and is available in multiple formats including video, web and print. The Hubbis e-learning platform consolidates this wealth of knowledge into an indispensable training and development resource for all professionals.

What we do

Events Presentations Thought leadership	Publications News & videos Online content	Online learning Case studies Assessments

Topics we cover

REGULATION & COMPLIANCE	SKILLS
INVESTMENTS	STRATEGY & BUSINESS
FAMILY WEALTH	TECHNOLOGY

Who it is for

Hubbis offers a unique platform that brings together content, thought-leadership and collaboration - to challenge and provoke conventional thinking, with an aim to innovate and improve the Asian wealth management industry across the following segments: Private Banks, Independent Wealth Management, Retail Banks, Asset Management, Insurance, Technology, Professional Services. Through our events and content channels, we reach senior management, business heads and other key stakeholders from the top international, regional and domestic organisations.

Key highlights

- **120,000** monthly unique website visitors
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- More than **10** annual publications
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"FinIQ helps you trade the right product, at the right time, on the right venue."

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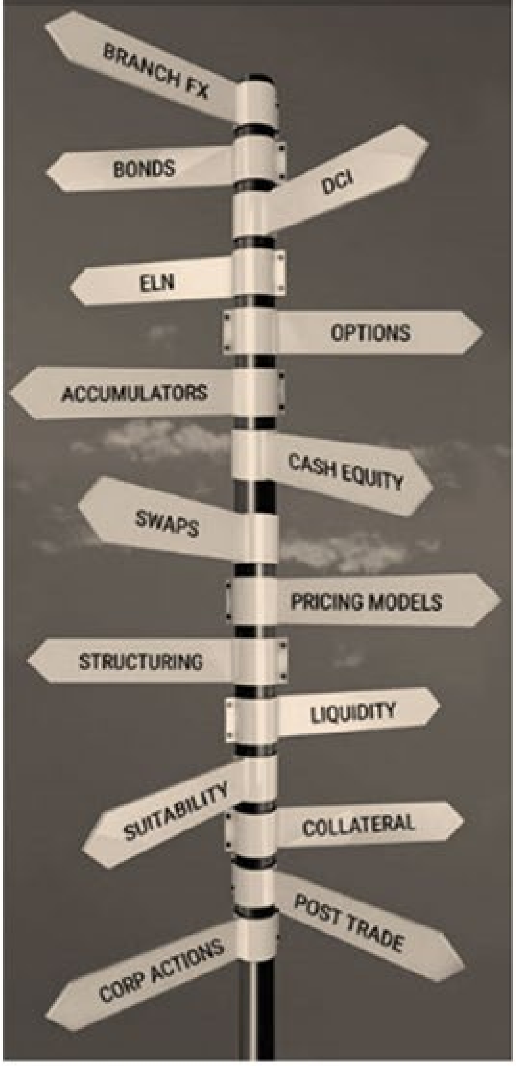
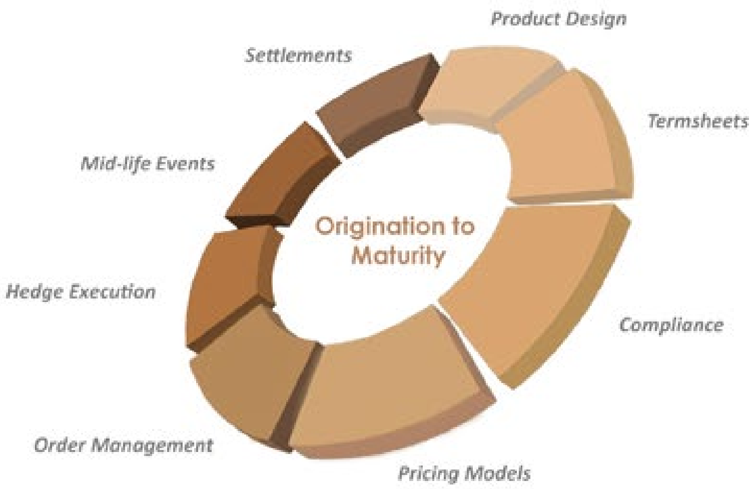
ABOUT US

PRODUCT OFFERINGS



- FinIQ is a Singapore based banking software provider. The FinIQ system is currently used by over 10,000 bankers spread across 60 banks in Asia.
- Over the last decade, we have enabled 25 different banking groups with their treasury, investments and structured product distribution leading to unprecedented revenue growth for our clients.
- Our solutions have the right emphasis on ease-of-use, workflow management, pricing efficiency, trade execution and post trade event management.
- Besides our wealth management offerings, we also automate retail branch network, corporate sales, share custody, option trading and various other workflows.

RICH FUNCTIONALITY



MILESTONES

2003
Worldwide interest rate crashed. FinIQ became first FX-option linked yield enhancement product platform to offer investment alternatives

2007
FinIQ launched end-to-end functionality for equity linked derivatives and investment products

2010
FinIQ structured product platform became widely used platform across Asia. FinIQ also launched compliance & client suitability frameworks

2012
Having succeeded in structured products FinIQ launched a range of cash FX, bonds, equities and other traditional products

2014
Cloud based SaaS live. FinIQ became worlds first multi-dealer multi-asset trading solution for Private Banks

Financial Industry In 2020

Structured products will be more bespoke with clients demanding increasing degree of freedom.

Real challenge will lie in how to deal with the non-standard products without software changes.

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GLOBAL FOOTPRINT

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The do's and don'ts of structured product issuance

With more investors looking at structured products, advisers need to be fully familiar with the regulatory requirements for selling the instruments, according to Richard Wu of Leonteq Securities.

The structured products industry has undergone enormous regulatory change in recent years, and more rule changes are likely to take place, with product listing likely to eventually emerge in Asia, according to Richard Wu, executive director and head of compliance at Leonteq Securities.

Wu noted that in some ways the market environment once more resembled the period shortly before the global financial crisis of 2008.

"There is a low yield environment, with low interest rates and greater volatility for various reasons," he said. "Because of that, it's created a lot of interest and more aggressive risk appetite for investors in banks and the wealth management industry. Investors are demanding more products to get enhanced yields."

The resemblance is important, because the onset of the global financial crisis revealed major structural weaknesses in the structured products market. When US investment bank Lehman Brothers declared bankruptcy in September 2008 many products had to be called off or redeemed.

At the same time, Asia's financial regulators faced large problems, with angry investors protesting outside the banks they blamed.

EDUCATION EFFORTS

As a result, the Monetary Authority of Singapore has issued many notes targeting intermediaries who sell products or advise clients on product purchasing.

Despite the outrage, Wu said that regulators are broadly supportive of structured products.

"The key point is that the regulators do want to see structured products on the market, because these are quite innovative products that are customisable by the investor and offer diversity to them,"

RICHARD WU
Leonteq Securities

Link to Presentation Video

http://www.hubbis.com/mainEvent/203_Structured_Products_Forum_-_Singapore/presentations.php?id=227&speaker_id=

he added. However, significant public misconceptions remain, mainly regarding the benefits and risks attached to structured products.

A key element of dispelling these views is improved client engagement and education, which regulators have tried to encourage.

"Investors have very different levels of knowledge and experience in trading products, and generally in understanding derivatives," Wu said.

"Some regulations have made the first point [for advisers] to be that you ask investors what they know about derivatives."

They have also offered very prescriptive guidance on customer advice, which raises compliance costs.

But this potentially offsets other costs.

"These efforts may reduce the costs attached to liabilities, and as you can see now the costs of legal liability are quite exorbitant in some areas, such as currency trading," said Wu.

There are also discussions about listing more products, as this will require more information disclosure, and make the process of KYC assessments easier. Additionally, Singapore and Hong Kong have introduced training and qualifications for selling structured products.

AREAS TO IMPROVE

Although the regulatory environment is now more rigorous, standards can still improve.

Wu said Hong Kong's Securities & Futures Commission typically sends mystery shoppers to a random 10 local institutions to see whether they fully explain structured products when selling them. "The survey found that although intermediaries are using standardised questionnaires to get client information they were not fully documented, and the representatives guided the investor [in filling out the form] so that they could buy more products."

Additionally, some representatives did not offer sufficient explanation about the disadvantages or risks of the products, or offer investors a proper explanation of the rationale of the products.

Some didn't give the product key fact statement either.

"This was just a random sample of institutions, but it shows that there are still problems. While the rules are in place, a lot of institutions are either not complying with them or not enforcing them," he said.

"There is a low yield environment, with low interest rates and greater volatility for various reasons. This has created a lot of interest and more aggressive risk appetite for investors."

LISTING LESSONS

Europe and the UK have focused their regulatory efforts mostly on product development. Wu said there is an obligation when an issuer manufactures a new product to design and develop a distribution strategy and put into place a secondary market for that product.

"The European securities authority also asks for more transparency in the products they sell; they are talking about [issuers and distributors] disclosing profit margins to the end investor and the cost of hedging and distribution, so the investor knows how much you make from them," he noted.

Europe's regulator is also considering creating key investment documents, which standardise all key information for structured products to investors.

Wu's hope is that products are listed on regional stock exchanges. "It offers re-sale opportunities and can develop a greater secondary market for investors to sell products before maturity, while providing objective pricing for products and price discovery mechanisms," he said. "It also removes some of the issues attached to secondary markets that are created by issuers themselves, such as non-transparent structures."

He said there is a long way to go in Asia to develop such structures, with exchanges in Hong Kong and Singapore yet to decide what products could even go into them, and whether they have the technologies to support such a product market.

"These issues need to be worked out for products to be listed and traded on the market. But I think it would be good for the settlement and redemption of these products." ■

Engineering investments to add more value

The flexibility of structured products means they can offer investors a variety of investment options that vanilla financial instruments cannot, and dovetail closer to the investment expectations of buyers.

Investors should consider investing into structured products because of their ability to closely reflect the investors' views on the market in a transparent manner.

When discussing the value such products can offer investors, Jeremy Ng, deputy chief executive officer for Asia at Leonteq Securities, pointed to their inherent flexibility, using the example of an investor wanting to buy Apple stock, but finding it 10% over-valued.

"A cash trader would have to sit there until it drops," he explains.

"But instead of waiting you could look to a simple reverse convertible [product with Apple stock as an underlying and] a strike price at 90%. Because you short the option you earn a premium [while Apple shares trade at over 90% the initial value], and if at some point [the Apple stock drops] you can have that as well."

"True structured products are relevant and attractive relative to more transparent and direct financial instruments due to the fact they are very flexible."

CHARLES PICARD
BNP Paribas Wealth Management

Charles Picard, head of structured products and tailor-made derivatives at BNP Paribas Wealth Management in Asia, offered similar thoughts.

"True structured products are relevant and attractive relative to more transparent and direct financial instruments. This is particularly due to the fact they are very flexible.

"They can answer any type of investor need, any risk-return objective in your risk appetite."

He noted that all client types use structured solutions, such as companies using them to optimise their balance sheets for finance, hedging or offshore accounting purposes, and hedge funds conducting arbitrage.

> **"We are in the sixth year of an equity bull market and if you go back the bond bull market has arguably lasted 30 years. We have to look beyond these asset classes."**
>
> **HANS GOETTI**
> Banque Internationale A Luxembourg

TECHNOLOGY AID

A key support to the proliferation of structured products over the past two years in Asia has been the increased ease with which they can be modelled and constructed.

Ng says this is down to marked technology advances, which make it easier.

"Technology can help take care of executing structured products in an efficient way; otherwise it costs a lot of man hours," says Ng.

"This leaves a gap in time in which the manufacturer and distributor can engage in deeper conversations that end up adding value for their clients or investors."

Inevitably, most of these conversations in Asia tend to revolve around yield enhancement products, which is the key driver for most regional investors to buy structured products.

Delegates at a Hubbis event in Singapore were asked for their sentiment around the question 'Where do investors tend to place the most value in structured products?'

The clear winner was 'investment returns', at 83%.

'Diversification and capital protection' only gained 9% apiece, and 'hedging' received zero votes.

MARKET CONDITIONS

Hans Goetti, chief strategist, Middle East and Asia, at Banque Internationale A Luxembourg, added that structured products offered investors much-needed investment diversification at a time of mounting risk.

"Usually a [discretionary portfolio] is mostly bonds and equities," he said.

"But we are in the sixth year of an equity bull market and if you go back the bond bull market has arguably lasted 30 years."

"We are getting to a point where we have to look beyond these as at some point trends end. And structured products can also offer exposure to other asset classes in the commodities space, for example."

Ng added that the products could also fit markets that have proven to be range-bound of late.

"A lot of portfolio managers have an investment benchmark to compare against and in an environment where there isn't much return, they can be range-bound," he explained. "Some discretionary managers have used structured products in such a market to outperform."

Similarly, the products can also take advantage of an interest rate environ-

WHICH OF THE FOLLOWING SHOULD BE THE MOST IMPORTANT THING DISTRIBUTORS LOOK FOR FROM PRODUCT ISSUERS?

Source: Hubbis Structured Products Forum 2015 - Hong Kong

ment that could begin to rise later in 2015, after years of being flat.

"The next rate environment is likely to be a hiking one, and people can look to interest rate-linked structured products to help outperform," he said.

Delegates at the Hubbis event in Singapore were also asked for their sentiment on another topic: 'Which of the following should be the most important thing distributors should look for from product issuers?' The available answers were: 'cheaper prices'; 'product innovation'; 'after-sales service'; and 'information and education'.

"It is really all of the above," said Goetti, when asked his opinion. "However I would go for product innovation, as it's important to find more ways to play on certain assets."

You can potentially put a structure together on almost anything you can think of and that's where you can have an edge as a manufacturer," he added.

The audience differed slightly in their views of the question.

In total, 36% voted for after-sales service, while 32% voted with Goetti's preference of product innovation.

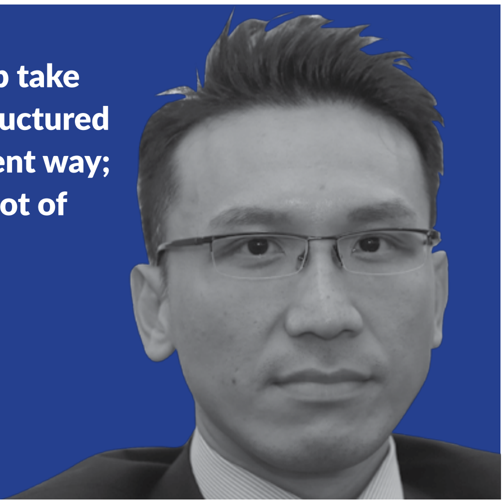
The panellists also noted that there is a slight difference in product preference between investors based in Hong Kong versus Singapore.

"Over the past three years we have seen a bigger investor appetite for flow products in Hong Kong, with roughly 80% to 20% flow versus non-flow products and bespoke solutions," said Picard. "This is a bit different in Singapore, which is 60% flow and 40% tailor-made customised solutions. Hong Kong is more transactional; Singapore is more structuring-focused."

While the yield focus of clients in both cities looks likely to remain, Goetti concluded with a note of caution.

"I think bonds are the most overvalued asset class on the planet," he explained. "They used to be risk-free return but now they are return-free risk. Investors should seek ways to find a hedge against that." ■

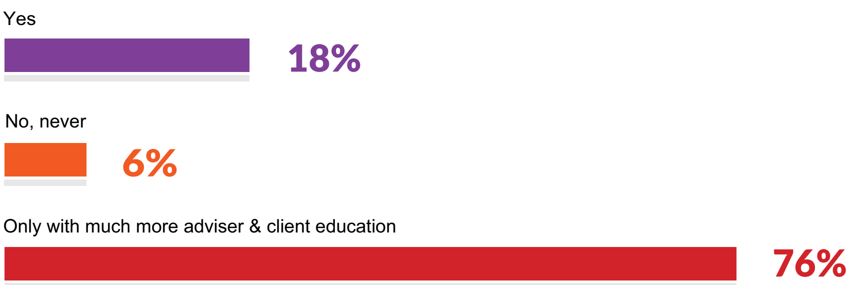
"Technology can help take care of executing structured products in an efficient way; otherwise it costs a lot of man hours."



JEREMY NG
Leonteq Securities

"Bonds are the most overvalued asset class. They used to be risk-free return but not they are return-free risk."

CAN STRUCTURED PRODUCTS EVER BECOME A MORE SIGNIFICANT PART OF DISCRETIONARY PORTFOLIOS?



Source: Hubbis Structured Products Forum 2015 - Hong Kong

The value of investing in basic structured products

Relationship managers (RMs) need to fully grasp the way structured products work and adapt them to meet HNW clients' preferences if they are to work well, says Peter Williams of Leonteq Securities.

It is vital people selling structured products understand how they work. Yet this is easier said than done, according to Peter Williams, director of structured solutions sales at Leonteq.

He said RMs need to start by asking a client what their investment perspectives are, and what return they want to achieve, then begin to determine what products might be appropriate.

"You can facilitate and customise products for the customer's requirements," Williams noted.

"For example, if a customer has a yield requirement of 5.5%, 6%, or 7% per annum, this can be factored into the product and the risk of the product can be put into which underlying [financial instrument] we use."

KEY PRODUCT ELEMENTS

He explained that structured products have four basic elements: capital protection; yield enhancement; participation; and leverage.

However, there are around 400 payoffs based upon these four.

Williams went on to offer quick descriptions of some common coupon-focused structured product types.

Reverse convertibles essentially pay the client a guaranteed coupon; barrier reverse convertibles observe a barrier condition and pay a guaranteed coupon; multi-barrier express certificates observe more than one underlying instrument; an express certificate has an auto call feature and can be redeemed early; fixed coupon notes are essentially the same as a reverse convertible; and twin-win offers positive exposure to potential upside and downside movements of the underlying.

He added that the difference between European and American barriers is that

PETER WILLIAMS
Leonteq Securities

[Link to Presentation Video](http://www.hubbis.com/mainEvent/202_Structured_Products_Forum_-_Hong_Kong/presentations.php?id=507&speaker_id=)

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the former are observed only at a product's maturity, whereas the latter are observed on a continuous daily basis.

Important date terminology references include observation dates, which are typically quarterly or semi-annual dates upon which the underlying instruments are matched against their initial fixing; and the maturity date, which is the final fixing date of the product.

PRODUCT PAY-OFFS

Williams went on to use Tencent as a popular stock underlying in Asia to demonstrate some simple products.

"If you look at Bloomberg analysis; Tencent has 90% buy, 10% hold and no sell recommendations across 15 analysts," he said. "It looks attractive even if you end up buying [its stock] outright."

He gave the example of a US dollar fixed coupon note structure with Tencent as an underlying, with a six-month maturity, continuous monthly observations and an 80% barrier. Williams said this product could pay investors 16.21% per annum, or 1.35% per month.

"Essentially, [with this structure] your market expectation is that the underlying is either moving sideways or rising slightly," he added.

The best outcome is for the stock to move above its strike price in the first month; the product auto-call out means the client receive 100% of their notional investment plus a 1.35% coupon.

The second scenario would be that the product runs the full six month tenor, with the client receiving a 1.35% coupon six times over its lifespan. The worst case scenario would be that Tencent's stock falls below 80% of its initial fixing, in which case the investor would be long the underlying at maturity.

Even then, the investor would get six coupons of 1.35% upon maturity.

> **"There is a low yield environment, with low interest rates and greater volatility for various reasons. This has created a lot of interest and more aggressive risk appetite for investors."**

ALTERNATIVE INVESTMENTS

A bonus certificate is an alternative structure. Using DBS as an issuer, a six-month maturity US dollar-denominated product with underlying Tencent shares offered upside participation of 150% and a barrier of 85%.

In one scenario, provided Tencent's shares dropped by under 15%, investors would receive their notional investment at maturity plus a 5% bonus coupon.

In the second scenario, if Tencent's stock price had risen by 10% above the initial fixing on maturity, investors would receive 115% due to the 150% participation rate on the upside. (There is a 125% cap on the participation rate,

KEY STRUCTURED PRODUCTS TERMINOLOGY

PAYOFF TYPES
- Reverse Convertible
- Barrier Reverse Convertible
- Multi Barrier Express Certificate
- Fixed Coupon Note (FCN)
- TWIN WIN

PRODUCT CHARACTERISTICS
- Conditional/Guaranteed coupon
- Memory Coupon / Non Memory
- AutoCall Trigger
- Phoenix
- Athena
- Participation

POPULAR BARRIER TYPES
- European Barrier: Worst Of
- European Barrier: Sum Of
- American Barrier (Continuous / Daily on Close)

DATE TERMINOLOGY
- Strike Date (Initial Fixing)
- Issue Date
- Observation Dates
- Maturity Date (Final Fixing)

Source: StructuredRetailProducts.com

so investors could get a maximum return of 137.5%).

In the third scenario, if the stock had fallen to below 85% of the strike value on maturity, the client would be long the underlying Tencent shares.

Williams' last product example was a twin-win certificate, or an instrument in which an investor can benefit from up or down movements of an underlying. His example was a one-year US dollar product using the S&P GSCI Crude Oil Index as an underlying, with quarterly observations.

The product would offer a coupon of 4.875% per quarter, an American barrier level of 60% of the initial fixing, and a strike level of 100% of the initial fixing.

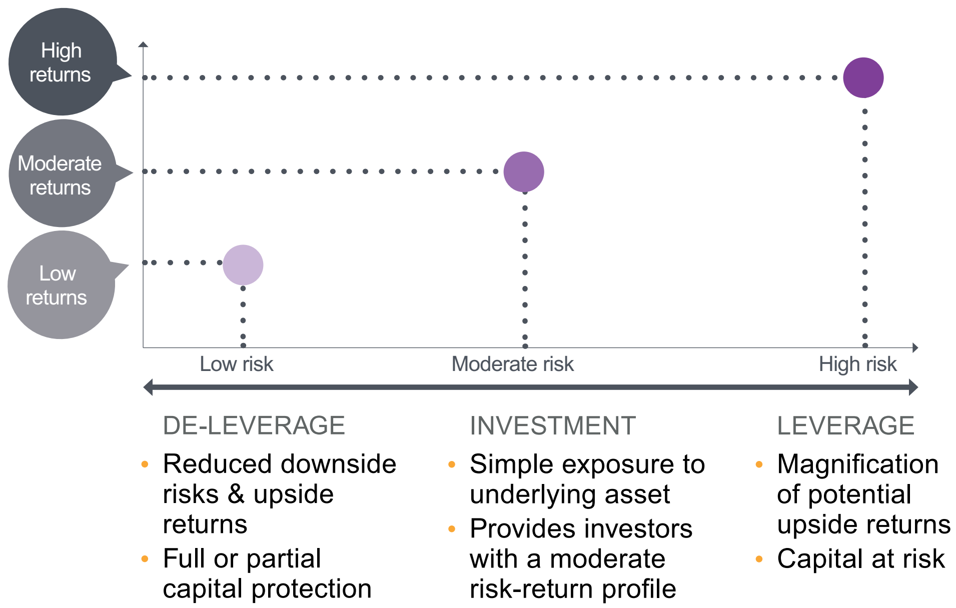
In scenario one, if the underlying rose above the strike price in the first quarter, the investor would get their notional investment back plus 4.875% coupon. In scenario two, if the underlying dropped a small amount in the first quarter the investor wouldn't get a coupon, but if it then rose above the strike price in the second quarter the investor would get a 9.75% coupon, to reflect both quarters' performance.

In scenario three, if the price of oil rose or fell 10% by maturity, the investor would receive a 10% participation payment. Lastly, if the price of oil fell 40% during the product tenor the client would be long the underlying.

Williams ended by noting the applicability of each product entirely depends on the client's market expectations. "The key takeaway from these examples is that you need to understand the client's requirements and apply these into the correct structured product for them."

"The key takeaway from these examples is that relationship managers need to understand the client's requirements and apply these into the correct structured product for them."

RISK VS. REWARD



Source: StructuredRetailProducts.com

A collaborative approach to raise the structured products bar

More practical tools and information needs to go into the process of educating relationship managers (RMs) and clients about how and where structured products fit into their portfolios.

The level of knowledge and understanding among the majority of RMs and other client-facing staff in Asian wealth management about structured products needs to improve to ensure they are capable of discussing them with clients – and in a way that can clearly explain how they apply in their portfolios.

Part of this comes down to giving bankers a targeted range of products that are relevant to their specific group of clients. It can also be achieved by delivering training to the bankers via a combination of different delivery formats, including mandatory training, to get the right concepts into their heads most efficiently.

And if RMs and advisers can help their clients understand more about the full range of products they can potentially use for their portfolios, then everyone stands to gain – as clients can assess for themselves what is suitable and this will help them to be able to meet their individual objectives.

"Product issuers must also share a certain amount of responsibility for educating investors."

ALESSANDRO CAIRONI
UBS Wealth Management

COMMUNICATION VITAL

The relative complexity of many structured products makes it essential that there is more interaction among the various stakeholders involved in creating and selling these products.

"Without a continuous dialogue, the sell-side cannot know what the buy-side or end-clients are thinking," says Philip Cheng, adjunct associate professor of finance at The Hong Kong University of Science & Technology.

As someone who has worked on both sides, he should know. For example, he

> **"There is a lack of useful material and information to actually help clients make decisions."**
>
> **MAHESH BULCHANDANI**
> FinIQ

explains, the sell-side needs to understand what issues the buy-side faces in terms of their sales process.

Alessandro Caironi, head of capital markets sales, APAC, at UBS Wealth Management, says that the product issuers must also share a certain amount of responsibility for educating investors.

This is increasingly the case given how busy the typical RM is, plus the many other types of products available to choose from.

Perhaps the most important part of the education process, he adds, is listening. "Rather than just trying to pitch the product of the day, the key to doing sales in the right way is to start listening," he urges.

EDUCATION WANTING

The amount of real client education which happens leaves a lot to be desired, according to an audience sentiment poll.

According to Mahesh Bulchandani, chief executive officer for FinIQ in Asia, this is partly due to the lack of useful material and information to actually help clients make decisions.

The majority of the so-called efforts to educate clients tend to be based on a few specific products, rather than what Caironi says should be on the bigger picture in terms of why clients need to use structured products, and which types, for example, are suited to whom.

Without the tools, therefore, RMs, who ultimately have the most responsibility for client education – according to most practitioners – are stifled.

While it is relatively easy for bankers to create a product based on a theme the client likes, Mark Stephens, founder and chief technology officer of Simulytics Systems, says it is far from straightforward to determine which combination of equities and which level of capital protection level will meet the target return of the client, and with an appropriate level of risk.

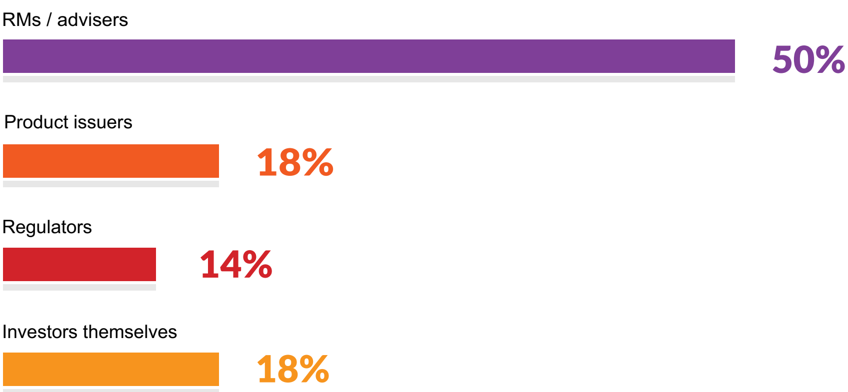
He questions the extent to which clients really understand the risk in a structured product in terms of the potential probability and magnitude of losses to which they may be liable if they invest in it.

At the same time, giving clients some real insights and education is also an opportunity for RMs to be able to differentiate themselves.

STRIVING FOR SIMPLICITY

An essential aspect to enhancing the education process is to be able to explain products in simpler terms and

WHO SHOULD TAKE THE GREATEST RESPONSIBILITY TO EDUCATE CLIENTS ABOUT STRUCTURED PRODUCTS?



Source: Hubbis Structured Products Forum 2015 - Hong Kong

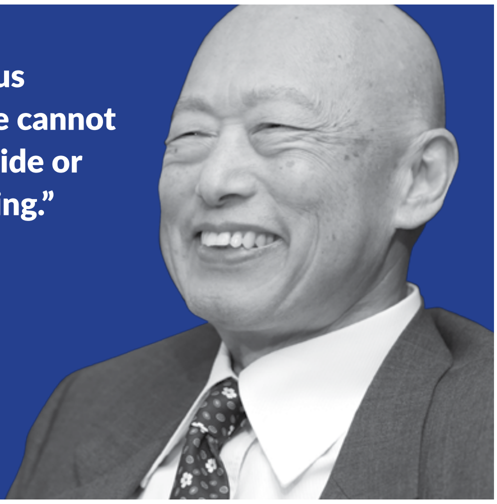
therefore make them more accessible to a wider audience.

"These products can be explained more simply if you really explain what is happening," says Bulchandani.

"In Europe, they put a simple factsheet on the top to achieve this."

He says he believes that there is no product that cannot be described in simple terms.

> **"Without a continuous dialogue, the sell-side cannot know what the buy-side or end-clients are thinking."**
>
> **PHILIP CHENG**
> The Hong Kong University of Science & Technology



WHAT WILL HAVE THE BIGGEST IMPACT ON IMPROVING THE SALES PROCESS AND GIVING THE FRONT-LINE MORE CONFIDENCE?

Source: Hubbis Structured Products Forum 2015 - Hong Kong

Indeed, it is a tall order to expect a client to be able to understand literature explaining a complex product when it may only constitute a small part of their overall portfolio.

Adds Stephens: "There is limited time in a client meeting to cover very technical and complex products, so there is a good argument for simpler products with less complexity, and that can be explained more simply."

Pushing for this and trying to simplify the conversations between RMs and clients, for instance, is, however, easier said than done.

After all, Caironi says there is a vast amount of information that he and his bankers are required to put in front of clients, to help them understand the product better. But this doesn't make the products any more relevant for a particular client.

Yet Stephens says that a chart showing thousands of reconstructed past performances across many market cycles, for example, provides the best way of explaining a product's nature to a client.

"Without such information a client may not be aware of the potential consequences of a note should the market change suddenly in a dramatic way as it periodically does."

MAKING IT PRACTICAL

According to panel speakers, by applying scenarios to a client's portfolio can help show what a structured product can do.

This is important given the number of variations of products that exist.

"We need to make it more tangible and show them what solutions there might be to address specific situations," explains Caironi.

For example, by focusing on a particular issue or concern that clients are likely to have based on the wider markets, a potential solution can be proposed.

“Giving clients real insights and education is also an opportunity for RMs to differentiate themselves.”

MARK STEPHENS
Simulytics Systems

Getting clients involved in the process of training and education is another option to improve understanding about how structured products work and how they can be used within portfolios.

“It’s one thing asking a client to sign a pile of disclaimers to say he understands the risk. It is quite another to actually give the client some real meaningful understanding of the potential risks they face, especially in extreme market conditions,” explains Stephens. ■

In line with this, Stephens believes there should be a distinction made between shorter term ‘flow products’ that serve a need among HNW investors to be actively involved in managing their money, and products which are geared to longer tenures.

These might be use with trust money put aside for children, and for preserving and growing wealth longer term.

“There should a place for structured products in both areas of a client’s portfolio,” he explains.

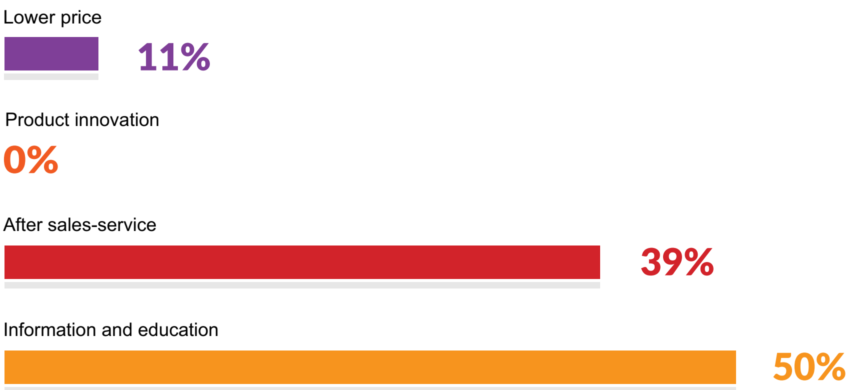
“With the more conservative, longer term portion, greater emphasis on targeting, the risk characteristics of a product is required, and the client is not gambling with this money he wants it invested,” he adds.

This type of approach might also enable bankers on both the sell-side and buy-side to introduce new instruments that have to date been largely neglected in Asia because of the way the market in this region has developed.

IS THERE ENOUGH CLIENT EDUCATION TODAY ABOUT THE PRODUCTS THEY ARE BUYING / SOLD?

Source: Hubbis Structured Products Forum 2015 - Hong Kong

WHICH OF THE FOLLOWING SHOULD BE THE MOST IMPORTANT THING DISTRIBUTORS LOOK FOR FROM PRODUCT ISSUERS?



Source: Hubbis Structured Products Forum 2015 - Hong Kong

Income through structured solutions

While equity-based structured products ran into problems during the financial crisis of 2008, product manufacturers have returned with sophisticated products that help investors take advantage of the markets, says Steve Tang of Leonteq Securities.

It is estimated that there were about 30,000 structured products with a total volume of over USD300 billion in the Asia Pacific region in 2014. While demand for these products had fallen after the financial crisis, institutional investors seem to have done their homework and returned stronger.

"The need for structured and tailored solutions has grown, and as clients have become more sophisticated they have become more willing to invest in these products."

"The need for structured and tailored solutions has grown, and as clients have become more sophisticated they have become more willing to invest in these products," says Steve Tang, director-structured solutions, private banking sales, at Leonteq in Hong Kong.

Hong Kong, South Korea and Singapore are the key markets with investments in structured products with accumulators, equity linked notes and fixed coupon notes taking up the limelight.

The reason why many clients appreciate structured products, he explains, is because there is scope for innovation and the market delivers sophisticated products, month after month.

STEVE TANG
Leonteq Securities

Link to Presentation Video

http://www.hubbis.com/mainEvent/202_Structured_Products_Forum_-_Hong_Kong/presentations.php?id=508&speaker_id=

PRIMO MULTI PERFORMANCE CERTIFICATES

Most structured products benefit from correlation increasing: fixed coupon notes on the worst, barrier reverse convertible etc. As a result, trading desks are usually short correlation, making the price of that correlation extremely high compared with where it realises.

The Primo Multi Performance Certificate addresses the point above, says Tang. "The investor, by entering the certificate, sells the implied correlation and takes advantage from its high level."

> "In the context of low or negative interest rates and low yields, meanwhile, investors have been looking for alternatives to vanilla bonds."

The investor benefits as well from a double protection at maturity, he explains. This is in terms of a classic European Barrier, observed on the sum of performances, and an extra capital protection feature, if the best performing underlying is above the Primo Protection level at maturity.

This Certificate also offers a high guaranteed coupon, as well as an autocall feature, if the sum of performances is positive on any particular observation date, adds Tang.

At maturity – if the product has not been autocalled – if the sum of performances of each underlying since inception is negative, but above the barrier of -50% (or if any underlying closes above 95% of its initial fixing), the investor will receive 100% of the denomination; this means the Primo Protection is active.

Otherwise, if the sum of performances of each underlying is at or below the barrier of -50%, and none of the underlying closes above 95% of its initial fixing level at maturity, then the investor will receive the denomination reduced by the sum of performances of each underlying. "The investor cannot lose more than the initial investment," confirms Tang.

DISPERSION CERTIFICATES

According to Tang, most structured products are directional; they generate gains if the market view of the investor proves correct.

In some market conditions, some companies tend to do well and others tend to do badly, so there is dispersion.

"The coupons, paid on an annual basis, are market neutral," he explains. "The value of the coupon only depends on how stocks disperse from each other and not on whether they go up or down. By choosing a diversified basket of stocks, the investor extract value from that dispersion phenomenon, whatever the market does."

In a slightly more technical approach, by entering the Dispersion Certificate, the investor sells the implied correlation, taking advantage of the high level of the implied correlation compared to its realisation, says Tang.

Essentially, the dispersion coupon takes the performance of all the stocks in the basket into account, he adds.

Here again, the idea is for the investor not to be exposed to some specific stocks in the basket, says Tang, but to the basket as a whole.

"Dispersion is hence defined at the average distance of the stocks to the average. By choosing a basket of well diversified stocks, the investor will take advantage of the dispersion among those stocks."

LOCK THE BOND CERTIFICATE

In the context of low or negative interest rates and low yields, meanwhile, investors have been looking for alternatives to vanilla bonds.

The Lock the Bond certificate may be considered as an alternative for bond positions which have had a good performance so far with the dropping rates environment, but which have now run their course leaving investors with a lot of downside and almost no upside, explains Tang.

In the case of a Lock the Bond event, which he says can happen as soon as in three months' time, the Certificate becomes a coupon-paying capital protected product.

"This allows the investor to move from the equity portfolio allocation into the fixed income portfolio allocation," explains Tang. ■

Innovation and trends in FX products

Given the notorious volatility associated with FX, the arrival of structured products in this space about two decades ago was welcome. Ken Tan of BNP Paribas looks at the evolution of these structures and their advantages to clients.

It takes 30 days for the New York Stock Exchange to match the daily trading volumes of the FX market. The average daily turnover of the latter is, of course enormous – USD5.3 billion worth, to be precise.

FX structured products were primarily created to counter this risk, although they're now used for a variety of purposes today by sophisticated investors, explains Ken Tan, head of FX investors solutions, wealth management and

"Although these products made their debut in the market only around two decades ago, they now constitute 50% of all structured products traded in Asia."

KEN TAN
BNP Paribas

Such a trading volume also points towards the risk that market participants face on a daily basis, regardless of their trading strategy, simply as a function of their engagement.

family offices distribution, global markets, at BNP Paribas in Asia Pacific.

And although these products made their debut in the market only around two

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decades ago, they now constitute 50% of all structured products traded in Asia.

Interest comes mainly from two categories of investors – private banks and professional investors on the one hand, and corporate investors on the other.

"There are quite a few sophisticated FX structured products available and in demand today," explains Tan. "Yield enhancement structures which are the dual currency investments (DCIs) and CNH certificates of investment, as well as, hedging structures which are the accumulators, target knock-out (KO) forwards and pivots are among the popular products. It's safe to say, FX hedging structures feature very prominently in the structured products space."

"Yield enhancement structures which are the dual currency investments (DCIs), accumulators, target knock-out (KO) forwards and pivots are among the popular products."

ROLE OF FX STRUCTURED PRODUCTS

By definition, FX structured forwards are hedging instruments. However, the applications have become far more diverse over the past few years.

Apart from using the products to hedge, clients are also using them to trade the market by taking a view on it – whether this is a directional or a range-bound view. Clients have also started using these products for re-structuring purposes, adds Tan.

Initially, people were looking to buy options as a way to hedge their risk.

As clients started understanding the product better, they realised that hedging by options was an expensive proposition and looked towards 'collars', or a combination of options, to achieve the same result at a lower cost.

Forwards were next in line to grab the attention of hedgers, says Tan. These are simple contracts that defer delivery on the spot, which help clients mitigate the risk of currency fluctuations at almost no cost. Where there were a series of cash flows in the future, a par forward is available; it is made up of a series of forward contracts, where the forward rates are blended into a single FX rate.

Popular as they were, however, both forwards and par forwards have their limitations, adds Tan.

There is no doubt that all these products helped clients achieve more, but there is no denying that there was a need, demand and the possibility to create more efficient products that provided better results, at lower costs and with fewer limitations.

The introduction of barrier or target features led to the rise of FX structured forwards, such as the accumulators, target knock-out forwards, and pivots.

ON THE THRESHOLD OF A RISK-MITIGATING REVOLUTION

In the aftermath of the financial crisis of 2008, meanwhile, Tan says the marketplace was calling for better risk management practices.

The result was the emergence of 'add-on' features in the FX structured products space. "While many 'add-on' features were designed to help clients improve the risk-reward profile of their hedge and provide a certain level of protection to the client, it was soon discovered that it was possible to use these structures to further enhance the strike in a bid to take a more aggressive stance on the market," says Tan.

Among the popular 'add-on' features created are the collar, the European knock-in, the advanced barrier, the liability knock-out, the capped loss, and the bonus strike.

The capped loss 'add-on' feature is something that Tan says he believes is very interesting at this moment in time. During periods of market distress, the benefits of such a structure are very pronounced. The recent market event in China demonstrated that the product compares very favourably against others in a similar category, he says.

It does so by shortening the exposure for the client to the risk of the structure when the client is in a losing position. ■

Innovation and trends in commodities

Despite the role of commodities in achieving diversification and target returns, investing in them has been trickier post-2008. But this is changing, explains Ker Lih Gan of J.P. Morgan, with simple structures to profit from the market.

Whether in Europe or Asia, the commodities market has about 22 important products that traders constantly observe – in isolation and as pairs.

While their behaviour has always been highly volatile and difficult to predict, the years following the financial crisis saw a series of periods with negative performance that caused investors to panic and pull out.

During the past year or two, however, the markets have undergone some changes which indicate the potential for strong growth and performance in the current economic environment.

"Commodities as a growth asset is a tough sell because in the past five years or so, commodities have been on a steep downward trend," explains Ker Lih Gan, who is part of the commodity investor solutions team at J.P. Morgan in Asia Pacific.

"However, commodities is your best bet in an environment where rates are rising

"The best way to monetise the de-correlations in the market is by using pair trades where the investor is long (or buys) one commodity and short (or sells) another."

KER LIH GAN
J.P. Morgan

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and inflation is rising in the near future," he adds.

MONETISING DECORRELATION

Before the financial crisis, there was strong correlation between commodities, equities and the bond markets.

Gan points out that the last two years, meanwhile, have shown a marked downward trend in the correlation between commodities and the other markets. "We're now seeing very low, or even negative, correlations with world bonds or US bonds," he explains.

The best way to monetise the de-correlations in the market, he says, is by using pair trades where the investor is long (or buys) one commodity and short (or sells) another.

Yet for any investor, studying and analysing 22 different commodities might be difficult.

And comparing them and finding pairs that could be used to trade in a way that helps monetise the de-correlations is even tougher.

That's where Gan's team comes in.

They study the momentum of the pairs, although the importance of using the seasonal momentum rather than simple momentum when deciding the directionality of trades in other asset classes.

"Seasonality momentum studies is how we decide to go long a commodity if it has performed well in the past, or short a commodity if it has not performed well," he explains. "In our studies, however, we isolate the performance in a particular month and compare it with the performance in the same month over the past 20 years."

These sorts of strategies seem to have become very popular after the financial crisis in 2008, he adds.

There are many advantages to them. Being a low volatility strategy, for example, it is possible to remove the impact of timing from investment into the commodities market, which helps investors. It also helps that the investors trade in commodity pairs where they long a commodity and short another – which captures returns within a reasonable range, on either side of the market.

> **"Seasonality momentum studies is how we decide to go long a commodity if it has performed well in the past, or short a commodity if it has not performed well."**

LEVERAGING AN ENVIRONMENT OF SHORT-TERM VOLATILITY

In an environment where short-term volatility is very high, there is a positive premium between implied volatility and realised volatility, says Gan. In such an environment, it is beneficial to sell option contracts on commodities on a long-term and diversified basis.

"The market has a large number of buyers of options but a very low number of sellers," he says.

"There is a structural imbalance in the demand and supply economics in this market because a lot of market participants need to hedge their risk of production or consumption against rising or falling prices, but not many investors are willing to underwrite or provide insurance against that risk through options."

This characteristic of the market is what Gan takes advantage of.

If selling options over a long period of time, implied volatility is generally higher than realised volatility and most of the options expire worthless – which is profitable for investors.

The way to efficiently explore these market dynamics, Gan recommends selling a call option and a put option on a commodity underlying – which is also known as selling a straddle.

This is done on a daily basis. The team then delta hedges the trade to ensure it reaps the insurance premium on the option from the contract.

"The difficult part of implementing a strategy like this is liquidity in the options market," he explains.

"This is why, when we design such a strategy, we do it on listed exchange options in the commodities space." ■

Creating a bigger role for structured products in portfolios

Redefining structured products as investment solutions and highlighting the benefits of them for risk control will create a difference in making them more widely used in portfolios.

Rather than structured products being considered and used as individual components with a portfolio, they need to be increasingly viewed by both bankers and clients as a fully integrated component within the entire portfolio.

In this way, they can be used to achieve specific client needs and goals, and understand the entire portfolio risk – if both parties are aware of the potential of different products and are able to monitor them on an ongoing basis.

As part of this, the focus needs to be on viewing them as investment solutions that fulfil the client's objectives from both a returns as well as risk-control perspective.

"Clients don't want to be sold structured products. They want something that can be put into their portfolio to deliver whatever solution they are looking for."

ADAM COWPERTHWAITE
Citi Private Bank

STRUCTURED PRODUCTS AS SOLUTIONS

A lot of the issues the industry has faced over the years in finding a greater role within portfolios for structured products has been due to the focus on product-centric features.

This flaw in the market has been compounded by the fact that flow products have had a traditional strong-hold among clients in Asia to date. As a result, investors tend to view structured products broadly as more of a trading tool, says Harmen Overdijk, managing partner of CAIDAO Wealth, an independent asset manager.

"What stands between the current level of usage of structured products and an even greater usage in portfolios is the jump from looking at single product features to understanding how [the

> **"Clients should look at structured products more as group of alternative investments."**
>
> **HARMEN OVERDIJK**
> CAIDAO Wealth

product] affects a portfolio," explains Harold Y. Kim, Ph.D, founder and chief executive officer of Neo Risk Investment Advisors.

After all, Kim says structured products are effective in achieving things they cannot be done otherwise, such as changing risk profiles, and therefore the risk-reward trade-off.

In this way, Overdijk adds that clients should look at structured products more as group of alternative investments.

More broadly, Adam Cowperthwaite, head of equities for Citi Private Bank in Asia Pacific, says that advisers need to talk about these products as investment solutions.

"The whole approach to structured products makes it sound like something you need to sell," he explains. "But clients don't want to be sold structured products. They want something that can be put into their portfolio to deliver whatever solution they are looking for."

This is more likely to come down to accessing a certain exposure more efficiently, or as a way to hedge or manage risk, or to adapt a portfolio.

"If more people think in this way, then there is much greater scope for structured products to play a big role within portfolios," says Kim.

According to Stephane Honig, head of sales, wealth management and family offices, global markets at BNP Paribas in Asia Pacific, the key with structured products is what they bring to the investor. This is based on the investment belief the client has and whether they are able to achieve that.

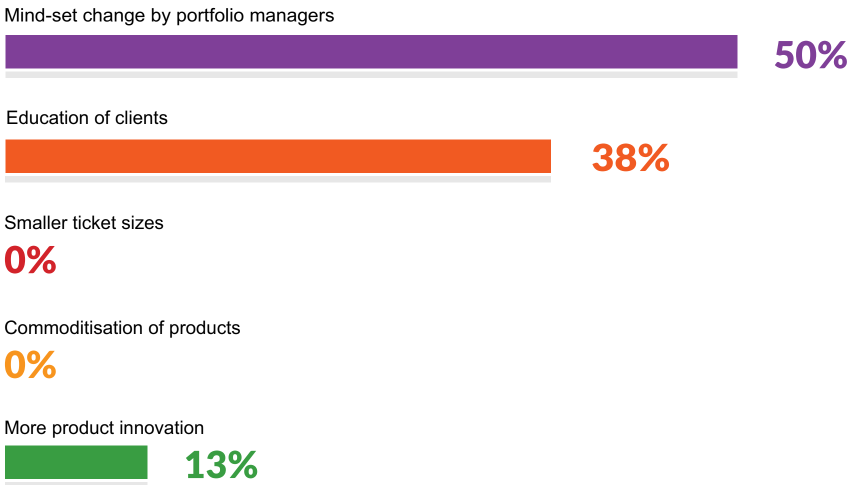
"From the perspective of the sell side, we need to emphasise more and more these products as investment solutions," he adds.

The recent volatility and continued uncertainty in the markets makes this a particularly good time for advisers as well as investors to think about moving more in this direction.

They can round out portfolios with some of these products.

"It is important for relationship managers (RMs) and investment counsellors to understand this," he adds, "so that they don't sell products in a narrow, singularly-focused way."

WHAT IS REQUIRED FOR STRUCTURED PRODUCTS TO PLAY A BIGGER ROLE WITHIN DPM?



Source: Hubbis Structured Products Forum 2015 - Hong Kong

ADDING REAL VALUE

While the solutions-based approach to delivering structured products to investors is the right way to go, it is difficult to implement.

To be able to do so in practice, Kim says RMs need to assess the clients' portfolios and figure out what tools and exposures make sense, based on what the client is looking for.

"We do this by showing clients how different types of risk control strategies, pay-off structures and also tilts can change potential outcomes for them," he explains.

At the same time, given the dynamic nature of the market, it is also important to help clients understand that there are always trade-offs, he adds.

Yet some clients react to structured products by saying they don't like them as an instrument.

This is possibly because they have lost money in the past.

"We show clients how different types of risk control strategies, pay-off structures and tilts can change potential outcomes for them."

HAROLD Y. KIM, PH.D.
Neo Risk Investment Advisors

However, clients don't always understand what they are trying to achieve when they are buying structured products, says Overdijk.

This might be in relation to what exposure they want, or what they want to achieve with the product.

Market trends are in the favour of the investor in this regard. For example a number of providers are providing increasing amounts of transparency on multiple levels. "The fact there are multi-issuer platforms is powerful for HNW investors," says Overdijk.

Another element which is holding clients back from viewing structured products as a key component of a portfolio is the hurdle for advisers in showing an idea to a client because of very tight KYC requirements.

The other key stumbling block, according to an audience sentiment poll, was a lack of education about how to best use products.

Other aspects included the lack of a clear definition of structured products; concern over performance uncertainty; and the lack of understanding of portfolio risk.

But panel speakers said that regulation has gone so far that advisers might not even be showing clients certain products which could be useful to them as part of their portfolio.

For example, explains Cowperthwaite, a client with a long equity position might want to write calls against that position.

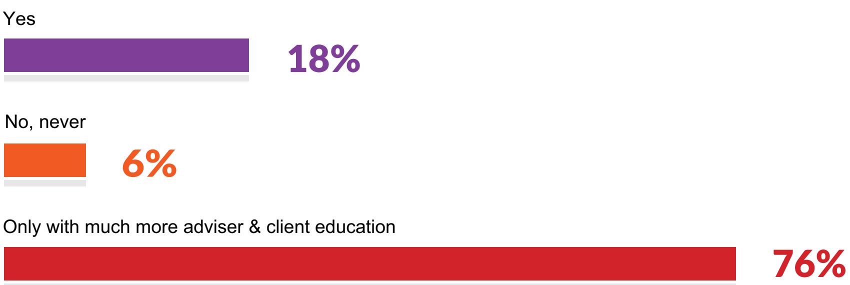
WHAT'S HOLDING CLIENTS BACK FROM VIEWING STRUCTURED PRODUCTS AS A KEY COMPONENT OF A PORTFOLIO?

Source: Hubbis Structured Products Forum 2015 - Hong Kong

WHAT IMPACT WILL MULTI-ISSUER PLATFORMS HAVE ON THE USE OF STRUCTURED PRODUCTS WITHIN PORTFOLIOS?

Source: Hubbis Structured Products Forum 2015 - Hong Kong

CAN STRUCTURED PRODUCTS EVER BECOME A MORE SIGNIFICANT PART OF DISCRETIONARY PORTFOLIOS?



Source: Hubbis Structured Products Forum 2015 - Hong Kong

While this is not taking a huge risk, it might feasibly be the case that an adviser won't discuss this with their client if that client doesn't tick the right knowledge and education boxes to have that solution shown to them.

DRIVING DISCRETIONARY MANDATES

There is also scope for structured products to become a more significant part of discretionary portfolios.

For example, says Kim, if discretionary managers start to understand how to transfer risk, and also risk versus reward with respect to structured products, he predicts a substantial increase in usage.

Ultimately, structured products give portfolio managers a tool to manage their risks.

And this is a fundamental requirement in any situation where there is an imperative to be invested, said speakers.

Yet even within the investment teams of some private banks and other wealth managers in the region, there is still a lack of trust to a certain extent in relation to structured products.

The perception remains among many that these are opaque, expensive and illiquid, explains Overdijk.

What could drive change, suggests Kim, is results, through seeing in reality the value of using these products as portfolio tools.

"These tools are not one-off structures and need to be viewed in a broader context," he adds. ■

How RMs can use technology to improve their value proposition

Appropriate technological platforms can help relationship managers serve their clients, provided they offer fast and thorough market and portfolio analysis, says Mahesh Bulchandani of FinIQ.

Utilising technology in HNW portfolio management can help a relationship manager (RM) become more effective in advising their customers, according to Mahesh Bulchandani, chief executive officer of FinIQ in Asia.

He noted that discretionary investing in Asia lies at only 10% of average HNW portfolios, versus 80% in Europe. However, the latter were looking to self-invest their money more.

"In Europe and the US the amount of self-directed investments are rising, slowly but surely," Bulchandani said.

The key reason for this, he explains, is the greater availability of information, which in turn leads HNW investors to believe they know what is going on and thus to make more of their own investing decisions.

This has made the RM's job more important and challenging.

"If you as an RM wake up at 7am and do your homework and check where FX and equities are, but a client calls and asks where a particular bond is and you haven't checked, you may be embarrassed. But you have 50 clients to cover, some of whom are into credit, while others are into FX or equity or onshore/offshore arbitrage," he said.

"To cover all this is difficult, so you need the support of technology."

The key advantage a technological platform such as that offered by FinIQ is that, among other things, it immediately shows RMs the investment positions of a client, and the real-time performance of those investments.

"If clients want to go above certain positions [they hold], the RM should be able to click and find out what the client holds and thus immediately learn more about the investment that they want to make," said Bulchandani.

MAHESH BULCHANDANI
FinIQ

Link to Presentation Video

http://www.hubbis.com/mainEvent/202_Structured_Products_Forum_-_Hong_Kong/presentations.php?id=503&speaker_id=

ADVISORY INTEREST

A good way to convince clients to consider product investing ideas is to use technology to compare their existing portfolio positions with new investment ideas and products on offer.

Any such portfolio view should be dynamic and up to date with the latest investments and most recent market data, as well as market events such as coupons, fixings and corporate actions. The technology solution should therefore be an integrated end-to-end solution covering the front-office, middle-office and back-office functions.

Bulchandani added that the ability to analyse a client's portfolio, recent trades and recent proposals also helps RMs avoid embarrassing incidents such as recommending an investment idea that a client has recently rejected.

FinIQ's solution can also help RMs keep track of the level of leverage each client is exposed to. "From a front-office perspective you want to know a client's credit position and what collateral they have with you as a bank and its level of concentration, and marry that with your firm's credit policies," said Bulchandani.

The RM can see if a client is bumping up against their leverage limits, and thus advise them of this immediately, as opposed to agreeing to leveraged investments that are subsequently knocked back by the bank's risk management department.

"[Using this technology] I know I need to show the product without leverage or find a way to bring into the dialogue the discussion about bringing more money. 'Look your AUM has been stagnant at USD3 million to USD4 million and I need USD5 million or more to give you a higher status. Can you bring more money?'"

"Information about collateral exposure is just as important as a client's portfolio positions," Bulchandani added. "You hear of clients who are shown an idea but when they try to place the order it is rejected by risk management. That is the best way to lose a client."

PRICING IMPORTANCE

Additionally, portfolio analysis technology can flag up investment events such as maturing bonds, allowing an RM to ask a client in advance how they wish to invest this money once it is available.

The platform can also give clients examples of how products will react, based upon particular strike rates or barriers. And it can combine historical market performance and structured product data, revealing likely strike scenarios.

"You can discuss yield and risk, and combine with this historical movement, and can say to the client 'this structure with this barrier makes sense as the barrier was seen a month ago, so therefore there is a higher chance of you getting knocked out and getting money back without having a stock delivery'."

Lastly, the technology ensures RMs can offer the best product pricing. "Pricing in Asia is the dominant factor," said Bulchandani. "If your clients are open architecture you need to be so too, or you may lose them to a competitor." ■

FINANCIAL INSTRUMENTS COVERAGE

FX

- Spot, forward, NDF, swap
- Flexible forwards
- Options, exotics
- Accumulators
- Target redemption forwards
- FX strategies
- Option strips
- Dual currency investment
- Triple currency investment
- Digital linked investment

Fixed Income and Swaps

- Primary and Secondary Markets
- Options
- Callable, Convertible, Inflation Bonds
- Interest Rate Swaps
- Cross Currency Swaps
- Credit Default Swaps
- Forward Rate Agreements
- IR Swaptions
- Overnight Index Swaps
- Credit Linked Notes

Equity

- Options, exotics
- Accumulators
- Decumulators
- Swaps
- Equity linked investment
- Quanto, KI, KO ELN
- Basket bull ELN
- Daily range accrual
- Fixed coupon note
- EQ booster notes

Others

- Mutual Funds
- Unit Trusts
- Exchange Traded Funds
- Certificates of Deposits
- Insurance
- Banking Deposits
- Gold Lending
- IPO financing, Loan Financing
- Loans
- EQ cash, exchange traded

Source: FinIQ

How fintech platforms will evolve the investment industry

The increasing use of financial technology platforms that can enhance the transparency, pricing efficiency and order execution process for structured products trades is expected to pave the way for greater investment in these instruments.

The use of financial technology platforms can increase the automation of structured product execution and post-trade services, improving the ability of distributors to handle many small orders and make pricing more transparent, say industry specialists.

In recent years, fintech advances have enabled structured product providers to deliver products far quicker and in a more efficient way, which has helped greatly when dealing with clients.

"When the markets were performing well nobody really cared if there were some inefficiencies or problems with product positioning or mis-selling."

ERDEM OZGUL
Numerix

"A few years ago we were playing a whisper game, with the client calling the relationship manager (RM), who then called the execution desk, who in turn called the product providers for prices and ideas," said Thibaud Gogny-Goubert, head of product and services development at BNP Paribas Wealth Management in Asia. "And often the client was not happy with them and so the whole process had to start again from the beginning,"

"Now, we are providing tools to the execution desk and RMs that are mainly to the benefit of the clients," he explained. "They get direct advice and pricing and if they are not happy with the price it can be changed in a second and they can trade."

Despite these notable improvements, technology providers next need to focus more on improving efficiencies in the middle- and back-office to better connect with their clients, said Mahesh Bulchandani, chief executive officer for Asia at FinIQ.

"Automation of the middle- and back-offices require change and adoption of technology on the buy-side as well as the sell-side," he said. "Sell-side has

> **"Now, clients get direct advice and pricing, and if they are not happy with the price it can be changed in a second and they can trade."**
>
> **THIBAUD GOGNY-GOUBERT**
> BNP Paribas Wealth Management

technology, but the bulk of that has been in market management, and less around the processes of connecting with the buyer and giving them the right price at the right time, or having auto management or processes around barrier watching, fixing, auto calls, maturities or redemptions."

LESSONS LEARNED

Rising regulatory demands for transparency and efficiency have acted as major impetuses for efforts to improve the connectivity of various distributors and clients.

"When the markets were performing well nobody really cared if there were some inefficiencies or problems with product positioning or mis-selling," said Erdem Ozgul, managing director for South Asia at Numerix.

"But market participants like Lehman Brothers went bankrupt with over one million OTC positions outstanding."

He noted that Numerix was appointed to put together a settlement framework of these positions with various counterparties across 25 jurisdictions. It used this experience to help create a multi-issuer financial technology platform called LAND to overcome many of the market's limitations, together with Leonteq Securities, Avaloq and DBS Bank.

The creation of multi-issuer fintech platforms generally confers many competitive advantages over single-issuer platforms, agreed Bulchandani.

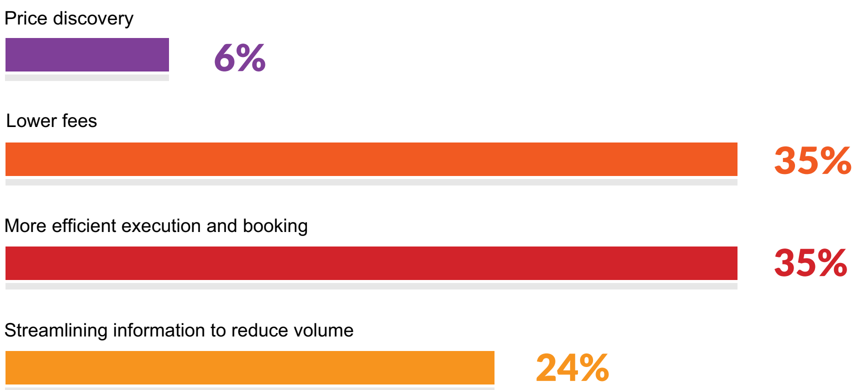
"I believe single-issuer platforms will see lower and lower [product issuance] volumes as the market matures," he said. "Especially in Asia, HNW individuals are open architecture. They have particular accounts with particular banks and can compare prices. If you as the [product salesperson] only use in-house prices you lose a lot of business, because you cannot be the best at everything."

Voting at a Hubbis event in Singapore asked the audience sentiment about which three characteristics most appealed about multi-issuer platforms: one-stop service; more products/choice; or cheaper prices. The vote was fairly evenly split, with 38% opting for the first option, 29% the second, and 33% the third.

Bulchandani said he believes the real advantage of multi-issuer platforms is that they will force distributors to focus on what they are good at, so freeing up resources for them to focus upon meeting the needs of their clients.

"The sell-side desk can focus more on generating ideas and access, helping

WITH GREATER AUTOMATION UNDERWAY IN THIS SPACE, WHAT SHOULD BE THE MAIN OBJECTIVE?



Source: Hubbis Structured Products Forum 2015 - Hong Kong

clients," he said. "They will provide a better quality of service to the buy-side, focusing less on jobs that can be done by computers and more on jobs that can be done by humans."

OPENING UP

Gogny-Goubert agreed that evolution would take place, with banks having to commit to becoming more open architecture, just as they have already had to do in market sectors such as cash equities and foreign exchange.

He likened it to the early days of the internet, an area he worked in during the 1990s.

"The big debate in the 90s for people building internet sites was to keep clients within the site once they clicked into it," he explained.

"So you had silly things like sites within a site. But sites like Google were open to everyone and they are the winners today. It's the same in our industry."

"Companies that are open-minded and provide a wide range of products to clients will be the winners of tomorrow," he added.

Another area that requires modification to create such open architecture is standardisation and comparison of structured products, added Ozgul.

"Today in structured products we have 30 providers but if you look under the hood no two products are equal and it is really difficult for investors to differentiate and compare [them]," he said.

"We believe there is [eventually] going to be one ecosystem where structured products can be specifically [compared with each other] with the layers, what it achieves and how it achieves it, and all the features."

He said that the biggest challenge confronting such developments is the fact that many private banks and product distributors have various legacy IT systems.

Additionally, Ozgul noted that many financial institutions have heavily-siloed operating systems when it comes to their various financial products.

"The banks have small, specific [IT systems], like sushi belts," he said. "And this one only has tuna and another one only carries salmon."

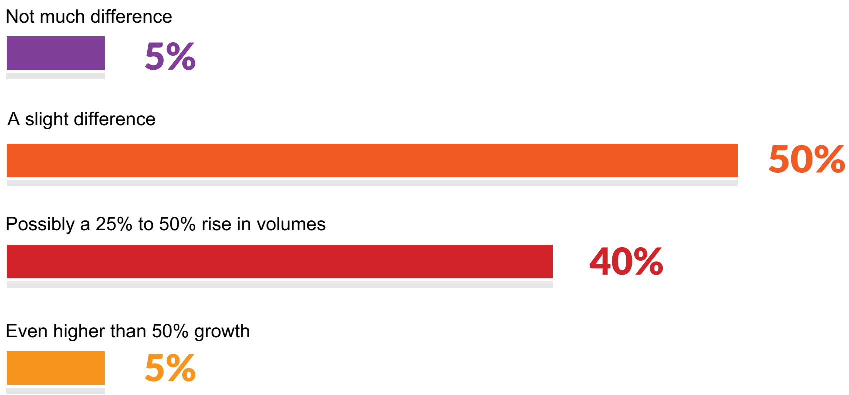
"Sites like Google were open to everyone and they are the winners today. It's the same in our industry. Companies that are open-minded and provide a wide range of products to clients will be the winners of tomorrow."

The relative age and variety of these systems makes it challenging to create a structured products platform that can fully access and process information to them all.

To have both, he says that he needs to stand up and go from one to the next.

"[Overcoming these siloed systems] is the challenge we face." ■

WHAT IMPACT ON CLIENT APPETITE DO YOU THINK MULTI-ISSUER PLATFORMS WILL HAVE?



Source: Hubbis Structured Products Forum 2015 - Singapore

LAND to give buyers and sellers space to expand products

The combined technology platform is designed to make it easier for investors to choose products transparently, and for product distributors to seamlessly execute these orders, said Erdem Ozgul of Numerix.

An expensively-assembled structured products trading platform created by Leonteq, Numerix, Avaloq and DBS is designed to let customers select tailored products while allowing distributors to simply and seamlessly execute these financial instruments.

The system, called LAND in reference to the first initial of the four contributors, could help revolutionise the appeal of structured products across more Asian customers, according to Erdem Ozgul, head of South Asia at Numerix.

"What are our objectives as partners? First of all, in terms of the technology side [it is] to leverage from the technology truly end-to-end [solutions], not just focusing on for example RMs (relationship managers) in terms of their relationships with clients and the execution desk or advisers or research, but looking at each participant and maximising the throughput or the efficiency of each participant," he said.

The four participants have done this by attempting to improve every step in the process of choosing, assessing and executing a product.

"We have looked at the complete value chain and tried to improve processes at every step," says Ozgul.

"We believe this can unleash financial markets, increase liquidity, make markets more transparent, accessible, and diversified, and also make them more regulator-friendly."

KEY PLAYERS

The LAND platform is designed to benefit buy-side and sell-side participants alike by offering structured products in a transparent, commoditised and highly secure fashion.

Each participant brings something to bear in this fashion. "Leonteq is a fintech provider and structured product manufacturer and distributor, and its ap-

ERDEM OZGUL
Numerix

Link to Presentation Video

http://www.hubbis.com/mainEvent/203_Structured_Products_Forum_-_Singapore/presentations.php?id=223&speaker_id=

proach has been to bring the experience from what it built in Switzerland where these products are almost fully commoditised," said Ozgul. "Today in Switzerland you can buy tailored products for as low as EUR1,000 (USD1,102) in nominal value, while Germany has an excess of 1.5 million products outstanding that are listed just on its exchange."

Numerix, meanwhile, is a leading pricing evaluation platform across all asset classes in treasury and capital markets as well as insurance, which offers solutions with structuring, independent risk management and evaluation.

These are key requirements in an execution- and risk-focused rules landscape.

"For the buy-side it comes to a one-stop-shop service, where they can access products from different service and dealers and use tools or RMs or independent asset managers or advisers to access the right product offerings and capture the right opportunities in market place."

DBS is bringing its business know-how and regional reach and expertise as an anchor buy-side and sell-side institution, while Avaloq offers sophisticated real-time pre-trade checks and post-trade processing. This is vital to prevent product errors or mispricing, which can be costly and embarrassing.

Leonteq and Numerix have spent almost USD1 billion over seven years to create the technology behind LAND; that marks a high barrier to entry.

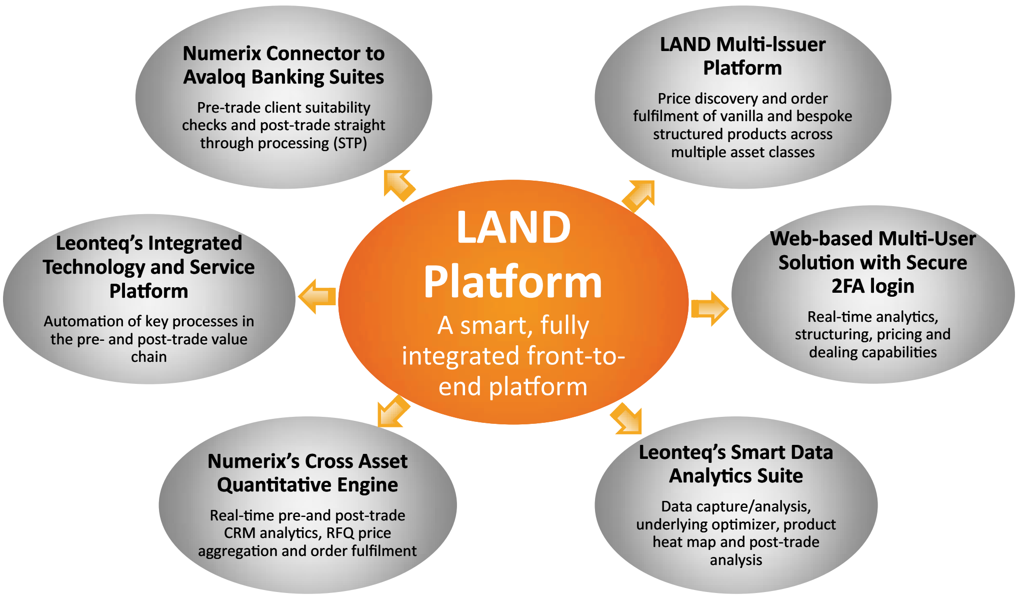
CHOICE AND EXECUTION

In terms of usage, LAND is designed to be intuitive.

Investors can enter the platform, choose their preferred underlying, product structure and pay-off, and immediately get a selection of the most likely products based upon smart data analytics in the system, said Ozgul.

LAND'S SERVICE SOLUTION

ONE-STOP SHOP SERVICE TO ALL MARKET PARTICIPANTS



Source: Numerix, Leonteq Securities, Avaloq, DBS

They also get indicative term sheets, product overviews and ideas of how the product is expected to operate under different scenarios.

It's important that the system offers a refined set of choices, as there are 2 million to 3 million different products a day on LAND.

"It has been a big data challenge, to slice and dice this information to end users in a meaningful way," said Ozgul.

Meanwhile the sell-side distributors automatically receive client documentation to ensure the products meet with the investor's personal preferences and that the instruments don't contravene any of his or her portfolio restrictions.

Once the investor executes the product, the system is designed to seamlessly go through post-trade settlement and checks, and present the customer with a non-legally binding fact sheet.

All of this is done through a secure private environment that "uses the latest security and encryption protocols where data that is communicated through a public network cannot be intercepted or hacked," said Ozgul.

UNIVERSAL TRANSLATION

The LAND platform is designed to universally translate to every bank or institution's particular technology too, to encourage the participation of more sell-side and buy-side companies.

The ultimate goal is to create a structured products eco-system.

"For the buy-side it comes to a one-stop-shop service, where they can access products from different service and dealers and use tools or RMs or independent asset managers or advisers to access the right product offerings and capture the right opportunities in market place," said Ozgul.

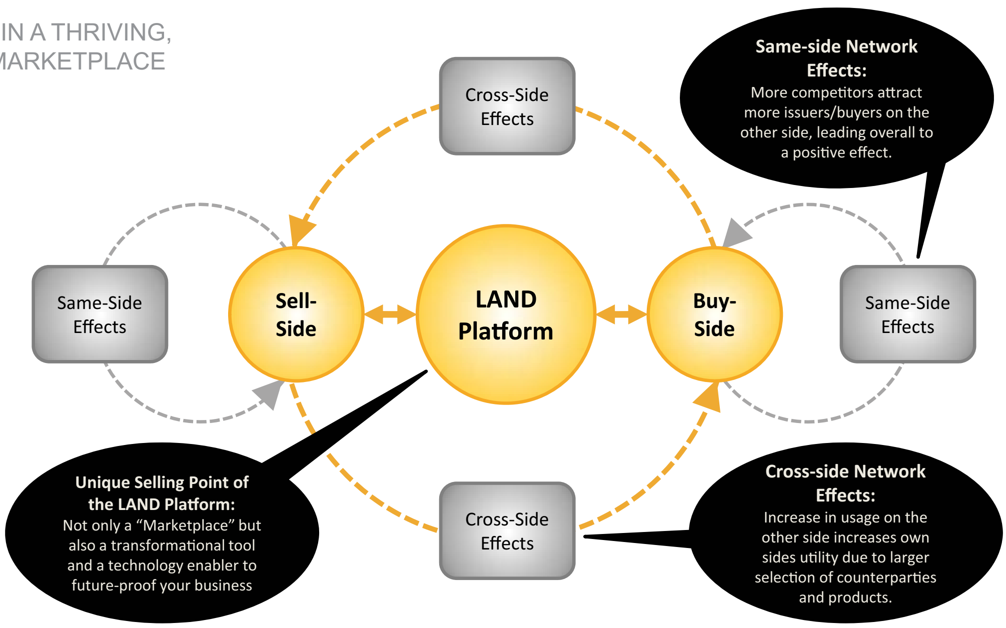
The appeal for sell-side producers is a broadening investor base, an easier way to cover a broader array of product options, and the ability to specialise at whatever product area they are particularly good at.

"Today if you consider the balance sheets of banks like DBS or UOB are completely different and so the products they can offer will be different," said Ozgul.

"It is the same with [all other international banks]." he explained. "By bringing more institutions onto platform it enables them to focus on their strengths rather than compete where margins are very tight." ■

ADVANTAGES FOR BUY- AND SELL-SIDE

SYNERGY IN A THRIVING, VIBRANT MARKETPLACE



Source: Numerix, Leonteq Securities, Avaloq, DBS

Advice on advanced structures

The jargon surrounding structured products can be intimidating. But with a bit of education, relationship managers can help put their HNW clients at ease with using them, said Duane Bong of Leonteq Securities.

"A lot of people say structured products are a black box and they don't understand how they work – they are too risky. So it's important to understand how the price moves," according to Duane Bong of Leonteq Securities.

Bong began by offering a basic definition of what structured products are.

"They are instruments that can give downside protection, and can tailor-make risk-return profiles to match whatever the investor likes," he said.

"If the investor is bullish you can offer him a bullish structure, and if he is bearish you can give him something that makes money when prices fall."

Bong said the financial instruments were relatively simple to understand, at least conceptually.

"Their nature of not simply moving with the market is the main advantage that structured products offer," he said. "For example, you can have a bond floor that prevents you losing more than 5% on your principal, so when prices fall you should not lose much money."

"But in return you might have to cap your maximum positive returns at 10%. That is the nature of these products and we should use that to our advantage."

GREEK MEASUREMENTS

Another key client misunderstanding is the fact that prices change, so that a structured product offered one day often cannot be replicated the next.

This occurs because many variables affect the price of the options embedded in the structures.

"We use Greeks to understand how structured product prices move," said Bong. "From a trading perspective you want a neutral book so the trader is not affected by price movements but to do

DUANE BONG
Leonteq Securities

Link to Presentation Video

http://www.hubbis.com/mainEvent/203_Structured_Products_Forum_-_Singapore/presentations.php?id=221&speaker_id=

that you need to understand the movements first."

Greeks are equations used to measure how much the price of the options embedded within structured products change, when they are subject to certain market variables.

There are several types. Delta describes how a product's option moves in relation to movements in the price of the underlying instrument. "You can always ask what a product's delta is," said Bong.

"If its delta is 50%, it means there is a 50% chance the product will pay out. Lower delta options are used where clients want to pay a smaller amount but have a huge pay-out. So if a product had a 10% delta and you put USD1 down, if it ended up in the money it would be worth USD10."

Vega describes how option prices move with respect to volatility. So if vega was -0.05%, as volatility drops the structure becomes more expensive by 0.05%. This can be important because certain events affect volatility.

For example, company stocks are often more volatile before an earnings announcement than afterwards.

"If a product depends on a lot of volatility and it has an earnings announcement tomorrow this can help you decide whether to price it today or wait," said Bong. "Usually clients are selling volatility so it's best for them to do so before this takes place, as if they wait too long the price will go up."

Theta measures the value of options as they age.

Most options have a duration of a year, and they gradually lose value each day as there is less time left for the derivative to be exercised.

"If an investor is bullish you can offer him a bullish structure, and if he is bearish you can give him something that makes money when prices fall."

Bong noted that a lot of structured products involved clients selling options, such as equity-linked notes or dual currency investments, or alternatively clients will sometimes sell call options for a covered call strategy.

"These clients want the theta to slowly erode the value of the options.

"They want to collect the option premium and sit on it, and hope the option expires worthless," said Bong.

He noted that if a USD1 million product has a -0.01 theta, each day it would earn the client USD1,000.

There are also a second set of Greeks, which Bong briefly described.

Gamma considers how delta changes with respect to delta, vanna measures the rate of change of delta with respect to vega, volga measures how vega changes with volatility, while charm measures theta with respect to delta.

"These measurements are like relationships with regard to speed," said Bong. "If you are going at 80 kilometres per hour and you accelerate, they measure how quickly your speed changes."

WHICH GREEKS MEASURE PRICE MOVEMENTS

Options	Increase in Volatility	Decrease in time to expiration	Increase in the Underlying	Decrease in the Underlying
CALL	+	–	+	–
PUT	+	–	–	+

Source: StructuredRetailProducts.com

CORRELATION CONSIDERATIONS

Another factor that is worth considering with regard to structured product investments, he added, is the level of correlation that exists between underlying instruments.

By using market data, product structurers can work out how much correlation there is between two assets.

"For example, oil prices have come down a lot, and so have the share values of BP and Shell," said Bong. "So these assets have a high correlation."

Other types of assets have a very low correlation, or no correlation at all.

"No relationship exists between such assets," said Bong, "so their price movements are entirely random with respect to each other."

Correlation can be useful to consider likely performance and therefore the likelihood of products paying out in the event of market movements.

For example, a US dollar investor with a Singapore share would be interested to know the correlation between US dollars, Singapore dollars, and Singapore share performance.

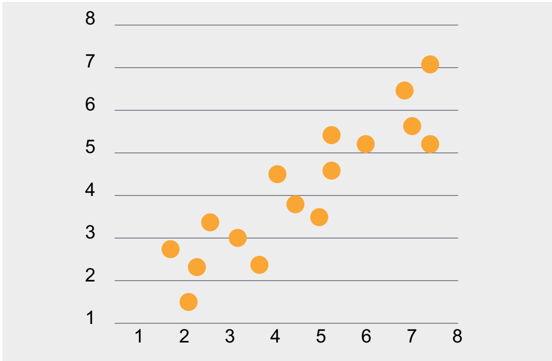
Alternatively, correlation can be used to help measure instruments that rely on a lack of correlation.

"If you have a worst-off product then you want low correlations, because you want one item to go wrong so that it pays out as it is more risky and instead you get a bigger coupon," said Bong.

"When you choose a basket [of underlying assets] you don't have to just ask a client 'what are you bullish on?'" ■

APPLICATIONS OF CORRELATION TO REAL LIFE - POSITIVE

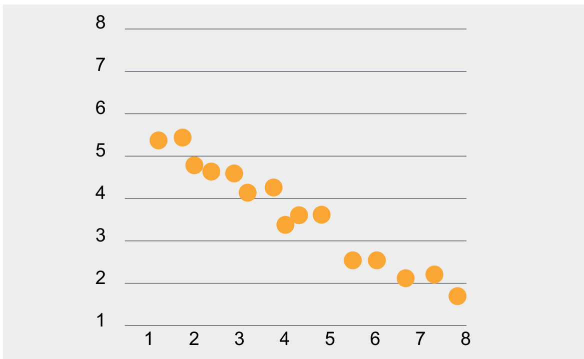
- Many PB structures have a return which is dependent on more than 1 asset
- Relationship is important as it has an impact on the price
- Positive: increase / decrease together (e.g. oil companies and oil price)



Source: StructuredRetailProducts.com

APPLICATIONS OF CORRELATION TO REAL LIFE - NEGATIVE

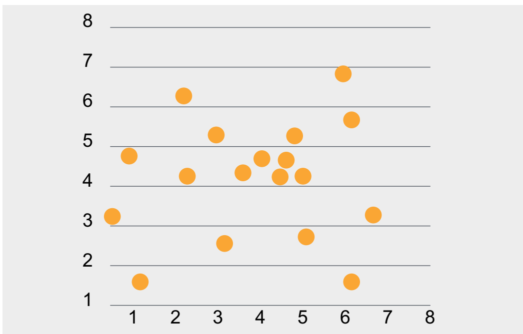
- Negative: as one increases, the other decreases (e.g. airlines and oil price)



Source: StructuredRetailProducts.com

APPLICATIONS OF CORRELATION TO REAL LIFE - NO CORRELATION

- Zero: No relationship between the assets Movements are completely random



Source: StructuredRetailProducts.com

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