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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, explained David Schmid of Leonteq Securities at Hubbis' Structured Products Forum 2015 in Singapore.

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 more automation and tailoring of products, David Schmid, chief executive for Asia at Leonteq Securities, said at Hubbis' Structured Products Forum 2015 in Singapore in early June.

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 quite remarkable is growth in the number of millionaires in Asia over the last five years," 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."

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DAVID SCHMID
Leonteq Securities

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hubbis

Structured products account for only 4% to 5% of overall wealth investments, so they have plenty of growth potential in the region.

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.

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 – mostly because there are very few listed products outside of warrants in Asia, while retail distribution has fallen away since the global 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.

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.

“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.”

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

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.

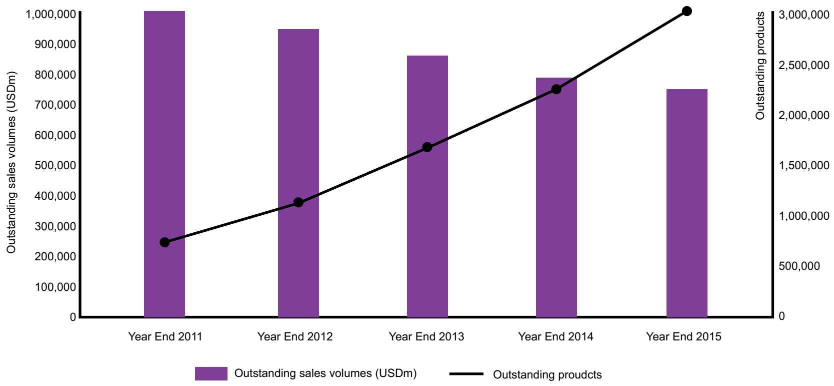
The far broader product range in Europe also comes with many more pay-off structures too; there are around 400 in Europe, versus just a few in Asia, with the likes of accruals, accumulators and equity-linked notes representing 75% of the market. Schmid said the breadth of payout structures in Asia will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

“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.”

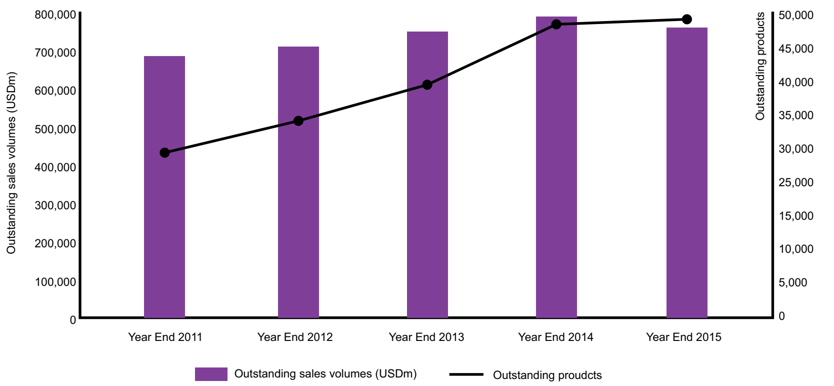
“Increasing regulation since the global financial crisis has reduced the number of products, and rightly so, but there are still worries about the potential for mis-selling, with people cautious after

EUROPEAN STRUCTURED PRODUCTS AUM



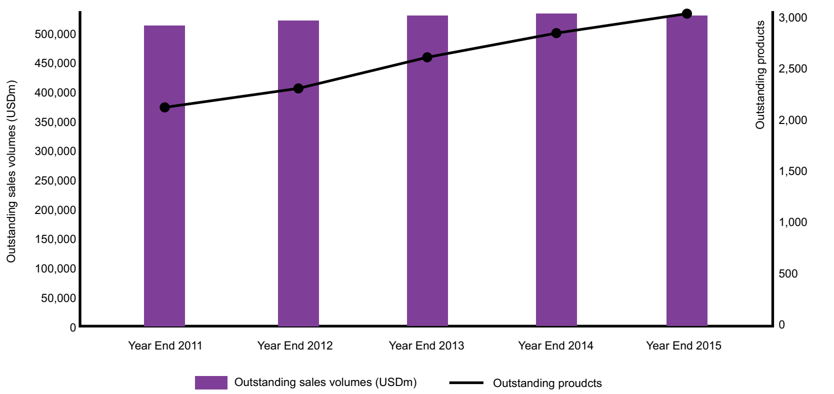
Source: StructuredRetailProducts.com

ASIA PACIFIC STRUCTURED PRODUCTS AUM



Source: StructuredRetailProducts.com

JAPAN STRUCTURED PRODUCTS AUM



Source: StructuredRetailProducts.com

the experience of [Lehman Brothers] minibonds in 2008."

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." ■