An emerging force in structured products

Barclays Capital is rapidly moving into a position of leadership in the structured products business

No one doubts that the structured investment products market is one of the most significant growth businesses for derivatives dealers, and that they continue to report exponential structured product sales increases to both retail and institutional investors. Leading the way in this developing area is a small group of sophisticated dealers that has the structuring expertise and creativity to continuously come up with new and interesting products. Indeed, there are very few dealers with the trading capacity and options know-how to be at the forefront of structured product issuance. Barclays Capital, which has won a reputation as one of the world's leading derivatives houses, has emerged as one of those few.

"In the early years, we focused on building a very strong flow capability across the various markets and, then ultimately, leveraging technology to transform the way core derivatives products are traded. But in the last two years we've had a growing focus on more value-added solutions," says Jerry del Missier, Barclays Capital's London-based head of rates and regional head for Europe.

Increasing its focus on structured products was a natural step for Barclays Capital, as it had all the essential elements in place to create a successful business, the most important of which was derivatives expertise across a number of product areas. "We have genuine multiple asset class capacity," says del Missier. "We're far from being just an interest rate and an equity house. We also have capacity in commodities, currencies and credit."

This broad base is essential in the structured products business. Structured products dealers have to have the flexibility to respond immediately to investor needs. The fickleness of investment markets demands it, for who knows which particular asset class investors in a geographic region or segment of the market will demand exposure to tomorrow? Who could have predicted a few years ago that so many investors today would be looking to take exposure to commodities, for instance? This is an important example because commodities markets have been an area that investors have been under-invested in, but it is also an area that has seen significant inflows in the last two years. It is also an area in which Barclays Capital has particular strength. "Commodities is a core business for us, and always has been. And we think that's an important differentiator," says del Missier, adding that investors have woken up to the fact that the asset class can offer solid long-term returns.

But having strength across the various derivatives asset classes is not enough to be a successful structured products player. To be a leading developer in this market a dealer also has to focus on the links *between* these product classes, as del Missier explains: "We are set up in a way that doesn't let product silos get in the way of multiple asset class structures getting developed and delivered."

He continues, "I think we are probably unique, certainly among the majors, in having an integrated multiple asset class sales force. We don't have the equity product going down an equity distribution channel, or the fixed-income product going down a fixed-income channel. That's actually been one of the draws for the marketing people that we've hired over the last couple of years – the ability to focus on multiple asset class business."

The idea is to have individuals that are focused on coming up with the best ideas that market conditions allow them to generate while, on the client structuring side, Barclays Capital has experts devoted to working out which products clients specifically want to see, whether they be capital protected, linked to a particular asset class or whatever. "We have people sitting there looking at volatilities, at correlations, at yield curves and so on to come up with products," says del Missier.

This approach maximises creativity among Barclays Capital's structured product teams, ensuring that the products that make it to market are relevant and interesting to investors. "If you constrain what your sales people can focus on, then you're not really delivering the best product via the best channel," adds del Missier. "Our open structure lets us focus on making sure that the product that we deliver is topical and, in addition, ensures we do not send confus-

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ing signals to the markets."

Aside from expertise in creating products, the other key element of this business is distribution. Structured products have been truly embraced by retail investors across Europe. It is a massive and growing market, with investors in countries such as Italy, France and Spain showing an eagerness in particular for capital-protected products. Getting your products to these end users is as important as having the proper expertise in place to create them. That means going through local third-party distributors, and a local approach to selling to them is essential. "If you really want to set yourself up to be responsive to the market, then you need to have people who are focused on individual countries and have a knowledge of the regulatory framework, as so much of this is driven by specific demands within the country," says del Missier. "At the same time, you want to take advantage of trends that are going on across the markets, so we have a matrix approach with a strong country orientation for direct marketing, which we overlay with some specific pan-European industry expertise."

Jerry del Missier, Barclay Capital's head of rates and regional head of Europe

Unlike some of its competitors, Barclays Capital has chosen not to buy up small retail banks across Europe to act as direct distribution channels to retail investors. Some banks would see this as a weakness. On the contrary, del Missier says the model of having a very strong centralized structuring capability in London serving European investors offers distinct advantages. "I think it makes us a more logical and strategic partner for local banks. Why would they do business with someone that is setting out to compete with them?"

Opportunities

The precision that comes from using derivatives to create structured products offers investors a number of benefits, most notable among them a high degree of flexibility. Structured products present investors with very clearly defined risk and return profiles. They can be structured to take advantage of bearish, bullish or non-directional trends, and have emerged as the ultimate exposure customisation tool. This flexibility means structured product solution providers can step in to fill gaps in investment markets that more traditional forms of investment are failing to address. Take, for example, the pensions market, which is facing a number of challenges.

"In the pensions space, you have companies having to face up to potentially very onerous liabilities from under-funded pensions, and then in Europe you have a changing regulatory landscape," says del Missier. "You also have governments facing up to the fact that, given the demographics in their countries, they may be looking at a pensions crisis at some stage down the road."

There is no easy solution to solving these problems. However, structured product makers are in a unique position to help because they can exactly match risk exposures on the liability side. And, as del Missier notes, the concept of asset-liability matching is becoming more important in the pensions space. "That really requires a knowledge of what's going on in each of the markets, as well as making sure that you are leveraging the expertise that you've developed," says del Missier. "I think it's clear that certain funds will need to change the asset mix of their portfolio, and ultimately, what is required are products that have a certain amount of embedded optionality. We've seen interest in products that combine an asset allocation shift, say out of equities into fixed income, with an overlay of an options strategy in order to either reduce the cost of hedging or to provide protection in the event that markets move in a certain direction."

This has also had a big impact on the inflation-linked market because inflation-linked assets are very highly correlated with pension liabilities. Barclays Capital is one of the largest inflation derivatives dealers, placing it in a commanding position to create inflation-linked structured products.

Structured products marketers such as Barclays Capital are also helping traditional long-only managers take their first steps into the alternative world. Many traditional managers want to take advantage of the strong returns exhibited by hedge funds but are wary of taking on direct exposure. Here, Barclays Capital is creating principal-protected products with upsides linked to hedge-fund performance. "The hedge fund and alternative space is an area that we focused on very early," says del Missier.

Clearly, Barclays Capital's structured products business has come a long way in a short space of time. In the last two years it has shifted its capabilities towards the more specialized and challenging ends of the business, across a number of different asset classes. But its ambitions do not end there. On the contrary, Barclays Capital is set to command even more of the structured products space.

"I think there are very good reasons why we are now set up to assume a position of leadership in this market," says del Missier.

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