

## US distributor

### Incapital

> In a game-changing year for the US structured products industry, Incapital's business might have been expected to suffer, with a product mix numbering 70% reverse convertibles and a rapidly contracting market. However, far from its business shrinking, Incapital sold US\$1.5 billion of product in 2008 – a 50% increase on 2007 – as a result of its astute adaptation to the new and challenging environment.

This is thanks to some intuitive planning, which put the distributor in a strong position to take advantage of 2008's events. "In late 2007, we really believed that over the next six months to a year we would see a shift away from the reverse convertible market to the principal protected business," says Adam Friedman, vice-president of structured products at Incapital, despite the fact that its reverse convertible business was booming at the time. Subsequently, the firm dedicated more time to principal protected and Federal Deposit Insurance Corp (FDIC)-backed products, with volumes leaping to \$50–60 million a month on the latter. Reverse convertibles, meanwhile, dropped to 30% of the product offering.

During this process, the distributor captured some opportunities that other businesses missed. In 2007, the US Treasury changed the law on Series I investments, which are government-issued, inflation-linked savings bonds. The change decreased the maximum investment from \$60,000 to just \$10,000. Simultaneously, fears over inflation increased among retail clients on the back of higher energy costs and government spending. This created a niche for a product, particularly a government-backed one, linked to inflation. Incapital filled this need with Consumer Price Index (CPI)-linked structures, moving to a certificate of deposit (CD) wrapper in September as credit worries grew. Incapital estimates that it sold \$200 million of these notes to broker dealers – a deal size you do not see on a lot of structured products, says Friedman.

Incapital's distribution coverage and activity boasts an impressive reach. After a month of distributing one bank's CD, the distributor had traded more notional than the institution's internal channel had in seven months. It now covers 800 broker-dealers, doing business with around 200 each month. In one deal Incapital might cover 70–100 dealers, some of which just are not on the map for issuers, says Friedman.

The distributor also traded \$300 million of constant maturity swap and steepener CDs as the directional view that the yield curve would steepen became more prevalent. It committed its own capital to the products, a considerable risk, and released educational material introducing broker-dealers to underlying concepts. "We noticed that there was a dearth of material out there on the rates side," says Friedman. "It's one thing to buy an S&P 500-linked CD. It's another to begin to understand the nuances of a rates-linked product." Some of the rates transactions hit between \$50–100 million.



From left: Glenn Lotenberg, Patty Cohen, Adam Friedman and Matt Larkin

This prepared the way for products from other independent dealers, but only after Incapital had blazed the trail. "There were a lot of times when we felt we initiated transactions and brought things to market that might not have otherwise existed," says Friedman. Issuers concur with this opinion, with one dealer at a major US bank saying that Incapital had a greater impact on the end market than any other distributor.

Incapital has also pushed the market forward with its secondary trading efforts, which increased hugely over 2008 and are helping to tackle the poor liquidity that has dogged structured products. The distributor has two people dedicated to secondary trading and will make a market in any issuer's structured product, even if it has never sold the institution's offerings. In 2008, the company executed 6,600 trades with 41 different issuers, racking up a notional value of \$318,539,620. One advisory firm says that it typically looks at a major bank subsidiary desk, then goes to Incapital to find the same offering cheaper. "Incapital has full disclosure so we know there's not a lot of mark-up," he says. This helps the adviser get the best price, and saves the issuer from having to deal with small trades – the average ticket size was \$47,814.

New issues are still listed on [structuredinvestments.com](http://structuredinvestments.com), which continues to provide an important educational resource for advisers. "I incorporate it into our internal web page on structured investments for our brokers to go in and view new issues and secondaries," says the head of one advisory firm. Now education has broadened into credit risk as well as product structure, given the events of last year. "We don't tell people what is a good or bad credit, but we educate people on how credit should play a part in their decision," says Friedman. Part of this includes explaining the difference between funding levels and credit rating. "Credit ratings are only one data point now," he says. I