

House of the year, North America

Wachovia Securities

> After years in the investment wilderness, the North American structured notes market seems finally to be coming in from the cold. Well-known European structured notes houses have been making in-roads in the region, and the usual US investment banking behemoths, with their massive derivatives trading desks, have also benefited from the new sales opportunities. But climbing the ladder fast in terms of issuance and distribution, and probably faster than any other player its class, is Charlotte, North Carolina-based Wachovia Securities.

James Whang, Wachovia Securities' director in the global structured notes group, says the bank's major switch to focusing on structured investments came in July 2003 when it agreed to a brokerage business merger with Prudential. As well as giving Wachovia a distribution capability in Latin America, and ultimately Europe and Asia, the merger also refocused its efforts in North America. "The structured note business really started to take off in the first quarter of 2004, and part of the push behind it was the result of the merger, which gave us the third largest retail distribution network in the US," he says. "More emphasis was placed on products that retail investors demonstrate a significant amount of interest in – structured notes being one of them."

After the merger, the bank's initial focus was on developing its corporate bond repackaging program. "Instead of being wholly reliant on issuers to be the host vehicle of a structured note, we created a proprietary vehicle that allows us to deliver very similar types of structured notes but through a trust vehicle. Here, from a league table perspective, in terms of numbers of transactions in 2004 and 2005, we have been number one by a long way."

This type of product wrapping is unusual when viewed from a European perspective. Technically, the investor buys a trust certificate that represents ownership in the assets of a trust vehicle. The issuing bank would, for instance, take a bond bought in the secondary market and deposit it in a trust, then overlay this with whatever derivatives are needed to replicate the desired market exposure.

The structure gives investors a lot of flexibility in terms of the level of credit risk they wish to adopt through the note and the maturity. The investor can effectively choose from a menu of credit ratings, maturities and market exposures.

A recent example is the STRATS-JP Morgan collared Treasury Bill floater. Here, Wachovia repackaged a JP Morgan secondary market bond (JP Morgan had nothing to do with the issue, which was completely proprietary to Wachovia). The structure, says Whang, was designed to mimic already familiar retail fixed income concepts, such as a \$25 par denomi-

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nation, three-month US T-Bill indexation, listing on the New York Stock Exchange, the use of a household name with an investment grade rating, and so on. Meanwhile, the STRATS product reinforced investor understanding of less typical retail security characteristics, such as coupon floors and caps, Whang says, adding this highlights the strategy of increasing awareness of broader concepts, which should ultimately result in the distribution of more sophisticated fixed income products to US retail investors.

"We highlight the customisation capabilities so if an investor wants a single-A security with seven-year maturity that protects them against inflation – instead of being wholly reliant on finding a single-A issuer that is issuing in the seven-year part of the curve – we can create that by going into the secondary market, where there is a huge population of products that fit the mould," Whang notes.

Wachovia says in 2003 and 2004 it printed nearly twice as many repacks as its nearest competitor. It also says it was the first in the market to issue an inflation-linked repack, the first to issue a repack linked to an emerging market bond and the first on the scene with a currency-linked note in repack form.

Whang says the bank is now starting to develop more capability on the trading of the exotic swap components behind structured notes. In terms of pay-off innovation, the big-name derivatives dealers may still lead the way, but in terms of distribution, Wachovia has very quickly earned itself a place at the top table.

Why Wachovia Securities won

The US structured notes market is still in its infancy and its growth rests on the shoulders of banks committing themselves to the market. Wachovia has made a big drive in the area – it notably hired nine structured notes specialists from Morgan Stanley earlier this year – and its repackaging business is going from strength to strength.