Structured products Awards 2005

House of the year, interest rates

KBC Asset Management

KBC headquarters, Brussels

As a regional structured products specialist, KBC Asset Management has always punched above its weight when it comes to innovation. Its quantitative and structuring expertise is second to none, and the Brussels-based outfit has never seemed to suffer from having a volatility and correlation book that must be much smaller than those of its larger international competitors.

The investment house has been at the front-end of fixed-income innovation over the last few years. One of its most successful issues ever, for instance, was its Maxisafe product, which was on the market during the course of 2003. Maxisafe was a bond with a swaption overlay designed to give protection on the downside. The payoff was linked to the middle part of the yield curve, around the eight to 14-year area, thus avoiding the short end where rates were lower.

The latest innovation also aims to give investors a decent yield in a low European interest rate environment, but this time KBC has gone as far as giving European investors overseas yield curve exposure. The Multisafe Interest Plus USD 1 is a 14-year product with a full capital guarantee, paying a coupon of 4.5% for the first and second years, and 5.5% for years three and four. In the following years, if the difference between the 10-year US-dollar swap rate and the two-year US-dollar swap rate is greater than or equal to 0, then the return is equal to the 10-year rate plus 1%, with a minimum of a 2% gain. If the difference is negative (the yield curve has inverted) then the gain is 2%.

The product is being sold throughout KBC's European distribution network. There have been three issues of the notes so far this year, representing sales of around €80 million. "We believe in dollar investments as a whole. The US currency delivers a much better rate of return at the moment than euros, and we also believe in the currency itself. It should appreciate," says KBC Asset Management's Arend Van Itterbeek, head of business development for Germany, one of the investment management company's key areas of distribution.

A major issue for investors and other financial market operators in the US at the moment is whether or not the yield curve there will invert, with the yield at the long end ending up lower than that at the short end. The Multisafe product pays a superior return if this does not happen, so it lets European investors take a view that the hype will not turn into reality. "We pick up the technical advantages of the forward market. Because of the cheapness of the option we can price in those high first coupons," says Van Itterbeek. "We believe the economic reality could be quite different to how the market is pricing it, so we can pick up the technical advantages of that while we support the client in debating whether the market is actually right in this."

From a technical – not to mention sales – standpoint then, the product is a winner. Not only does it give euro investors dollar returns, it also gives them high front-end payments and the possibility of an exceptional return of the US yield curve returns to its historical norm.

But what about that 14-year maturity and the associated duration risk? Van Itterbeek says that is not a problem.

KBC Asset Management's ability to innovate kicks in once more: "We hedge the duration risk inherent to the capital guarantee through a swaption overlay," he says, "which means we are protecting the secondary net asset value of the underlying zero-coupon bond while safeguarding the upside in case of decreasing interest rates."

Why KBC Asset Management won

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