

The Next Big Thing Is Here

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June 1, 2011

Structured CDs seemed to come out of nowhere. But they quickly became, arguably, the hottest products in the bank channel.

Sometimes called market-linked CDs, or equity-linked CDs, these products have displayed amazing growth over the last several years. They belong to the family of products collectively known as "structured investments," which also includes esoteric products like *reverse convertibles*, *buffered return enhanced notes* and *reverse exchangeables*. As such, many banks chose to keep these seemingly complicated and risky products out of their shops.

But over a relatively short period of time, market-linked CD sales have exploded across all channels, including banks.

While there are many iterations of the products, they all share a few basics: They're not securities or insurance, but at their "core" have an FDIC-insured CD protecting principal; they typically have maturities of three to seven years; and their return is tied to an index, a basket of securities or commodities. "In 2005, some \$17 billion in market-linked CDs were issued in the U.S.," according to Keith Styracula, founder, and chairman of New York-based Structured Products Association. He says that StructuredRetailProducts.org (the association's data provider) estimates that \$50 billion of structured products were sold last year, a 62% increase over 2009. A big part of this growth was in bank sales of market-linked CDs, he says.

So what's behind the rapid rise of sales of market-linked CDs in banks? Styracula believes there are several reasons. "These products are a natural fit in financial institutions," he says. "They're a natural fit for the conservative customer base. And the fact that a FINRA license, nor any license, is a requirement has helped fuel growth."

Certainly, this is part of the story, but Serge Troyanovsky, managing director and head of Retail Distribution North America, Structured Solutions Group at BNP Paribas, had other reasons as well. "We firmly believe in the strong potential of market-linked CDs in the bank channel," says Troyanovsky. "Traditional CD buyers have seen rates drop to such low levels that they are looking for alternatives. They are willing to give up a small guaranteed rate in favor of the opportunity of getting 8%, 9% or more."

Paris-based BNP Paribas Bank, the largest banking group in the world, launched its structured business in Europe about 20 years ago and for 10 years it has provided structured investment hedges to other leading issuers in the U.S. It also provided hedges to four of the six largest market-linked CD issuers in the U.S. With its acquisition of Bank of the West, it began offering market-linked CDs in the U.S. about 18 months ago.

Fabrice Hugon, managing director and head of Structured Equity Sales, also at BNP Paribas, noted that banks now account for almost 50% of their market-linked CD business. "Education has a lot to do with

our sales, whether it's provided by the issuer or by an intermediary. If advisors aren't comfortable with a product, if they aren't confident about key features and benefits, nothing will happen."

Stephen Amarante, president and CEO of Infinex, a third-party marketing firm based in Meriden, Conn. that serves about 200 financial institutions, agreed with the importance of education but had an additional explanation for the strong sales growth. "So many asset classes suffered over the past three to four years. Market-linked CDs meet the needs of the traditional CD buyers who aren't happy with current interest rates, who want the ability to participate in market increases but avoid any downturns. They've had enough losses in the markets. These products aren't for everyone, but we think they should be an important part of every FA's product arsenal."

There's little doubt that it takes more than just making the products available to generate the focus and motivation to really sell these products. According to Alan Blank, president and CEO of Midwood Financial Services and the first independent distributor to offer market-linked CDs to banks in the U.S., support is critical. "To us, support is wholesaling, and that means one-on-one [meetings] with FAs for training, product knowledge, sales ideas and support, support, support." He says that his nine wholesalers spread across the country meet with every FA at least once every six weeks. Blank estimates that Midwood sold more than \$1 billion in structured investments in 2010 and predicts a 50% growth for the firm this year.

While some bank FAs have seen their market-linked CD business explode, others are taking a more cautious approach. Robert Fradette, a 20-year veteran advisor now with Chelsea Groton Bank in Connecticut, says that about 5% of all his clients own market-linked CDs, all of which happened in the past two years. "There's been much more interest lately," he says. "With low bank CD rates and risk-averse conservative clients who still want guaranteed principal, many of my clients like the possibility of getting more. They're not for everyone, but I think market-linked CDs will be 10% of my business this year." Fradette also notes the importance of support. "It's not enough to just dump information on FAs using the Internet or mailers. I support the firms that support me," he states. "Some of these products can be pretty complicated and a good wholesaler can better explain how the product works and help me better present it to the right clients."

With sales continuing to grow at double-digit rates, there is not much that can realistically derail sales, according to those who commented for this article. "If fixed annuity rates rise, some sales will go here," says Amarante. "But this will just slow the rate of growth, not kill it," he added.

Blank at Midwood agrees that rising interest rates could slow sales, but only a little. "Even if interest rates go up, the manufacturers will adapt and adjust as they have in the past with guaranteed coupons, or add new features to the products to keep them attractive."

Styracula has a different perspective. "If interest rates rise, it means the terms of market-linked CDs will become more attractive and competitive against fixed-rate CDs." He also believes that the educational effort being made will continue to fuel growth for years to come.

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