Structured products Americas Awards

Structurer of the year, Latin America

Merrill Lynch

JJ Fernandez, Merrill Lynch

> Dealers are finding it harder and harder to distinguish themselves from their competitors when it comes to structured products innovation. Issuing new products on a weekly basis is no longer the preserve of an elite few structuring banks, but is instead taken as a given for any serious player.

With a centre of gravity on Wall Street and facing competition from large Spanish banks that may have a more natural affinity with Latin America, Merrill Lynch may not be the most obvious choice for structurer of the year for this region. However, a closer look reveals a bank that ticks more boxes than most when it comes to building and selling products there. "Pricing and performance are not enough," says JJ Fernandez, managing director and head of the structured solutions group for Latin America. "Sophisticated clients want an outstanding service together with a wide array of capabilities, at the level of both the structure and the underlying."

Merrill Lynch has launched over 300 new issues in the past 12 months in Latin America, including protected notes, yield-enhancing warrants, leverage structures, fund-linked products, hybrid products and commodity solutions. The bank has had particular success selling its auto-callable notes, says Fernandez. "Over the past 18 months we have created more than 80 new issues of auto-callable structures for our Latin American clients, on a notional in excess of $500 million," he says.

As the name suggests, auto-callable notes can be called back by the issuer if, on a certain observation date, the reference index closes at or above a call level. However, if the performance of the note is positive but the underlying does not break the barrier level, then the buyer receives a relatively high coupon payment but stays in the investment. If the performance is extremely positive, so that they are called, then the buyer receives the par value of the note. The buyer gets full principal protection and yield enhancement – because they are selling an option – while benefiting from current market volatility. "The spread between implied and realised volatility bodes well for strategies which systematically sell options, like auto-callable notes," Fernandez says. The call feature effectively reduces duration, he adds, while the client also gets daily liquidity.

Merrill Lynch has been selling auto-callable notes on a wide range of underlyings. Its Commodity Index Auto Callable Note, for example, is a five-year principal-protected note linked to the Merrill Lynch Commodity Excess Return Index (MLCI). The note pays a fixed coupon of 8.5% a year, subject to the MLCI being above the level it was at on the day the structure was issued, but not more than 15% above. If it is more than 15% above that level at any quarterly observation date, then the product is called back. The index is made up of a mixture of metals (30% copper, 15% aluminium and 5% zinc) and energy (30% oil, 15% natural gas and 5% heating oil). The product has been especially popular in Latin American countries, where investors may have a natural affinity with commodity investments. "People feel close to commodities in these countries – Chile is a country that depends on copper, while Argentina is very big in energy, and so on," Fernandez adds.

Merrill Lynch has also been using the auto-callable structure to give Latin American clients exposure to markets that until now they may never have considered investing in. It has had success in the region selling its Nikkei 225 Double Barrier Auto Callable Note to private banking networks for adoption by high-net-worth investors. This 10-year principal-protected note pays a fixed coupon of 9% per annum based on the positive performance of Japan's Nikkei 225 index. However, if the performance is slightly negative – no more than a 5% fall – then it pays a 4% coupon a year. It is also callable at 115%.

Structures like these show that Merrill Lynch is able to offer global diversification plays and enticing pay-offs while maintaining a local Latin American focus.

Why they won

Merill Lynch has fought off competition from large Spanish banks to become the pre-eminent structurer in Latin America, launching more than 300 new issues for the region in the past 12 months.