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Fee-Only Advisers Buy Bigger Share of U.S. Structured Notes

By Kevin Dugan - Jan 17, 2013

Registered investment advisers that charge clients fees instead of taking commissions on products bought their biggest share of U.S. structured notes last year since at least 2010.

Banks issued $2.59 billion of notes without distribution fees in 2012, 6.6 percent of the $39.2 billion total, according to data compiled by Bloomberg since 2010 of the bonds registered with the U.S. Securities and Exchange Commission. That compares with $2.92 billion, or 6.4 percent, in 2011, and $2.52 billion, or 5.1 percent, in 2010. Notes without distribution fees indicate that they are intended for fee-only advisers.

Advisers make up a larger percentage of structured note buyers because they are becoming more comfortable with the securities and are hunting for ways to boost returns, said Justin Capetola, managing partner at Blue Bell Private Wealth Management LLC in Blue Bell, Pennsylvania.

“You have to do something that hedges yourself a little bit and maybe gives you a little bump in yield,” he said. The yield on 10-year Treasury notes averaged 1.79 percent last year and touched a low of 1.3875 percent on July 24.

Blue Bell Private Wealth Management, which has $278 million in assets under management, buys structured notes from JPMorgan Chase & Co. (JPM), Goldman Sachs Group Inc. (GS), Morgan Stanley (MS) and Wells Fargo & Co. (WF), he said. As a fee-based adviser, it differs from the broker -dealers who sell most structured securities in the U.S. because it has a fiduciary duty to its clients and isn’t paid a commission on products it sells.

Sales to fee-based advisers are “a side of the market we’ve seen growing quite a bit, specifically on the note side,”said Deryk Rhodes, vice president of structured product trading at Incapital LLC in Boca Raton, Florida, in a Dec. 4 webinar. In a follow-up interview he said educational efforts have contributed to the increase.

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Smaller RIAs, whose clients tend to be high-net-worth individuals, are increasingly being courted by issuers because the assets of their customers are growing, said Xavier Avila, managing director and head of fixed income and currency structuring at Deutsche Bank (DB) AG in New York.

The RIAs don't have as many options as advisers with more assets, he said. They can choose to buy from a bank's existing product line, whereas a larger adviser can order a customized note to fit a client's needs, he said.

UBS AG (UBS) sold $998.2 million of notes to fee-only advisers last year, the most of any issuer. The Zurich-based bank's biggest offering, $946.2 million of one-year notes issued on May 16, was bought by Fisher Asset Management LLC. The securities yield twice the gains and losses of the Russell 1000 Growth Index, an index of companies with the fastest earnings growth.

Banks create structured notes by packaging debt with derivatives to offer customized bets to retail investors while earning fees and raising money. Derivatives are contracts whose value is derived from stocks, bonds, commodities and currencies, or events such as changes in interest rates or the weather.

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