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Banks Sweeten Structured Note Terms as Rates, Volatility Surge

By Kevin Dugan - Jun 27, 2013

Banks from Morgan Stanley to BNP Paribas SA (BNP) are offering higher than advertised rates on structured notes and market-linked certificates of deposit this month after Treasury yields and stock market volatility surged.

A wide range of U.S. securities may be affected, from those where the return depends on how equities perform to others where investors receive a coupon that floats above an interest rate benchmark.

Issuers may be under pressure to sweeten terms because falling market prices often make notes less valuable. The Standard & Poor's 500 Index dropped almost 4 percent in two days after Federal Reserve Chairman Ben S. Bernanke announced on June 19 that the central bank may begin reducing its $85 billion in monthly bond purchases intended to prop up the U.S. economy.

"If the market conditions change, people sometimes make updates to their offering," Serge Troyanovsky, managing director and head of retail distribution in North America at BNP Paribas in New York, said in a telephone interview. "In our case, the change in interest rates allowed us to offer better terms, and that's what we did."

Its Bank of the West unit increased the potential coupon on two market-linked CDs, he said. One offering, a seven-year CD sold June 24, initially yielded as much as 5.25 percent if a basket of five stocks stays above its starting value, according to an offering document. The bank increased the maximum interest rate to 5.5 percent, Troyanovsky said.

Volatility Soars

Issuers of structured notes registered with the U.S. Securities and Exchange Commission typically file an initial offering document, used in marketing, that includes either an estimated number or range for such terms as the return and amount of protection against losses. The final figures can change because the value of the securities depends on factors such as interest rates and volatility.

Price swings for the Standard & Poor's 500 Index, as measured by the Chicago Board Options Exchange Volatility Index, or the VIX (VIX), rose on June 20 to 20.49, the highest this year, while

10-year Treasuries rose to 2.608 percent on June 25, the highest level since August 2011.

"We've been trying to price some notes for the last four days, and every day we've waited, the numbers have gotten a little bit better" for buyers, Justin Capetola, managing partner at Blue Bell Private Wealth Management LLC, said in a telephone interview from his office in Blue Bell, Pennsylvania, on June 24.

Rates Jump

Jim Kaiser, president of FMG Distributors Inc., said the jump in Treasury rates was seen by most people as "a knee-jerk reaction." The 10-year Treasury note's yield jumped to 2.53 percent on June 21, a surge of more than a third of a percentage point from June 18.

"We thought they'd just as quickly go down and settle somewhere, and they really haven't," said Kaiser, whose securities brokerage is based in Norwalk, Connecticut.

Morgan Stanley, the biggest U.S. structured note issuer by sales, increased the maximum interest rate to 7.25 percent from 7.1 percent on a 15-year note tied to the lesser performing of the Euro Stoxx 50 Index and the Russell 2000 Index, he said.

Lauren Bellmare, a spokeswoman for Morgan Stanley (MS) in New York, declined to comment.

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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