

## 10 Myths About Structured Products

The UK Structured Products Association debunks some common myths about structured products.

In November 2009 the UK Structured Products Association was created to protect structured products from unfair and unwarranted comment since its members believe that much of the criticism is based upon poor understanding.

The Association has decided to publish responses to the 10 most widely heard myths about investing into a structured product which we deal with in turn:

### Myth 1

#### Structured products won't work in portfolio planning

Structured products are often considered as stand-alone investments and compared as direct alternatives to for example cash, equities or corporate bond funds. This approach is based on limited understanding of how to construct investment portfolios that manage risk and create asset diversity.

Structured products work best when used in conjunction with other investments where the defined returns and capital protection can be used to balance, perhaps, higher risk unprotected equity strategies or in lower risk portfolios to offer better than cash returns without risking capital.

In sophisticated portfolios structured products can also offer investors access to other assets or markets such as commodities or emerging economies with capital protection where investors can benefit in any uplift without directly buying into the market. This creates asset diversification into potentially volatile markets without necessarily increasing risk to capital.

### Myth 2

#### Structured products are too complex for retail investors

Just as there are many kinds of mutual funds, there is great variety within structured products. Depending on their needs investors can select from the vanilla to the complex, similar for example to buying open ended tracker or hedge funds.

What makes structured products stand out from the crowd is their transparency over how their returns are calculated. Payouts are often described as a formula based upon well known world indices with a specific investment horizon. Such products allow potential investors to clearly understand how a product will perform, both from a positive performance and downside risk perspective.

For a provider of a structured product to deliver transparent payouts that often differ from more traditional funds, products are hedged internally, a task that often needs derivatives. Considered in isolation derivatives are complex, but within a structured product they simplify investing because providers can define investment risk. It is perhaps the success of structured products and their transparency, that there is a desire to understand these elements.

### **Myth 3**

#### **Investors cannot get out of a structured product when they want to**

Structured products are designed to payout on a given day in the future and as such are designed to be held until maturity. Terms often range between one and five years depending on the product.

This fixed term nature is often misunderstood as meaning that there is no opportunity, no matter what an individual's circumstances are, to exit a structured product prior to this maturity date. This is often not the case.

Within Europe there is a vibrant and active secondary market in structured products, and there are many possibilities where the ability to sell such products and potentially realise any gains made, can form an important part of a clients regular portfolio review.

What investors must be aware of is that all fees are predetermined and taken upfront on a structured product and there are many market attributes that can affect the current price of a structured product such as interest rates, market volatility (as well as the index level be) and time to maturity. The impact is that even for products offering 100% capital protection, investors can get back less than they invested if they chose to exit a structured product early.

### **Myth 4**

#### **Investors can't access structured products in the same way as funds**

It is true that financial advisers and investors have historically not been able to invest in structured products through fund platforms. Which is in part been due to the infrastructure challenges of adding fixed term structured products to such platforms.

However, the market is evolving. Platforms are listening to the demand from financial intermediaries and investors and some already offer structured products from selected providers.

### **Myth 5**

#### **Structured products underperform unprotected equities**

Structured products can under and outperform unprotected equities depending on the structured product, the type of equity that is being compared and the prevailing economic environment when the comparison is made. The clear difference between unprotected equities and structured products is that the potential returns from a structured product are clearly defined and there is usually a degree of capital protection, which many investors find attractive when making the comparison.

### **Myth 6**

#### **Consumers cannot judge risk since providers don't disclose the counterparty or credit risk**

A number of providers in the past used the credit ratings of external agencies, such as Standard & Poor's, to describe the counterparty risk associated with a product. As the Lehman's event showed, a greater level of disclosure was felt necessary for retail investors. Today the leading providers of structured products take particular care to provide information such as naming of the underlying counterparty and education relating to counterparty risk.

### **Myth 7**

#### **Investors should avoid structured products because they don't benefit from share dividends**

Structured products often link the performance to the growth of an index, for example the FTSE 100. Normally the index chosen is known as a price return index which tracks the growth of underlying equities but does not include any dividends.

The reasons for this are clear and transparent. Structured products are designed to deliver specific returns based on expectations of market growth, often providing a level of security against market falls. Defining returns in this way means it is possible, in simplistic terms, to exchange one feature for another to create different returns.

Dividends are a good example, as often their positive 'value' can be used to help offset negative market risks - exactly the type of trade off that structured products specialise in. However, not all structured products forgo dividends and there are many products linked to assets such as commodities or emerging markets where there are no dividends.

## **Myth 8**

### **Structured products are not always available**

The market for structured products has grown considerably over recent years and continues to grow.

2009 has already seen more than 900 product launches with October alone seeing more than 100 product launches (structuredretailproducts.com), indicating there is a varied and regular stream of products available.

## **Myth 9**

### **Investors can't monitor progress of a structured product**

The structured products market has developed rapidly and the ability for investors and advisers alike to monitor performance has been one of the many areas that have seen advances.

Many providers are now offering product-monitoring tools on their websites and the introduction of structured products on platforms will mean more tools like this will become available.

Structured Products are not an investment panacea, but they can and do provide excellent investments that millions of investors currently hold as part of a balanced and well allocated portfolio. That they will continue to do so is not a myth.

## **Myth 10**

### **Structured products are too expensive**

As with all investments, there are fees associated that reflect the launch costs and expected profits. Whether it be the product research, creation of literature, distribution costs or indeed the cost of advice, these fees can be defined at the outset of a product's design and thus allows such costs to be 'in-built' into any product returns. This is due to the fixed term nature of structured products which allows providers to offer returns net of any fees. This enables investors to consider whether the investment meets their needs without having to consider the impact of charges, which can be an advantage.

These fees are not standard for every product, since products differ through payout, term, and how they are distributed. That said the costs, including advice, are typically between 1% to 1.5% per annum. This compares favourably with many, more traditional, investments.