Structured products, anyone?

Industry is comatose now but experts say it will be revived, taking new form and shape

Gabriel Chen

The structured products industry is dead. On the retail front, consumers are shunning these risky and complex instruments which dangle higher returns than bank deposits, while banks have stopped selling them.

And on the institutional front, bankers say that business is still alive but "struggling". Flows from funds and private banks into these products have also dried up.

The retail sale side looks even gloomier. "If you ask relationship managers whether you can buy structured products today, they'll just tell you, 'No, sorry'," said a 32-year-old wealth manager who wants to be known only as Mr Chia. "Nobody is selling them."

Not that anyone is buying either. "I bought into Minibonds thinking they operated like bonds, but they were more complicated than that," said 57-year-old investor S.C. Yong, who ploughed $50,000 into instruments linked to the now bankrupt US investment bank Lehman Brothers.

"There's a sense of being cheated. I'm disappointed with the regulatory framework, and I won't ever touch structured products again, not even with a 10-foot pole."

The market for these products plunged following the Sept 15 bankruptcy of Lehman Brothers and the subsequent uproar about how investors had been allegedly mis-sold products linked to it.

Just last year, an estimated $3 billion worth of such products were sold in Singapore. Among them were exotic structures like High Notes, Pinnacle Notes, Jubilee Notes and Minibonds.

Experts estimate that across Asia, US$200 billion (S$300 billion) to US$250 billion worth of products were transacted last year.

Numbers released by the Monetary Authority of Singapore show that big money was sucked into these products by investors here, who included retirees and the lowly educated. For instance, the total issue size of the Minibond programme was $508 million, of which $375 million was sold to about 8,000 retail investors through nine distributors.

Today, sales have plummeted to near-zero. The last publicised structured product was the All Weather Booster Notes arranged by Merrill Lynch issued on Sept 20.

The Sunday Times asked several banks whether they are still selling structured products.

Maybank said it is not "marketing" them for the time being. DBS said the only structured products it offers now are structured deposits, which are principal-protected. An OCBC spokesman said all banks, including itself, are "reviewing the sales process and the types of structured products that they will sell in the future".

These complex instruments made their way to the mass market here in 1999 and not only fuelled an era of growth for the banks and brokerages which distributed them, but also spawned the creation of thousands of jobs for traders, structurers and the relationship managers who sold them.

"In terms of volume, structured products were the most-sold products every year," said Mr Leong Sze Hian, president of the Society of Financial Service Professionals.

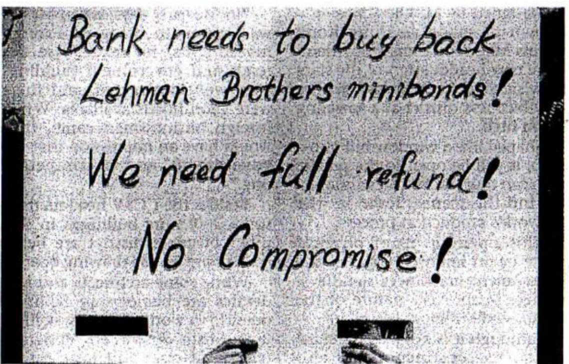

PHOTO: AFP

Experts estimate that across Asia, at least $300 billion worth of products were transacted last year. Above, investors protesting in Hong Kong.

After the Asian financial crisis from 1997 to 1998, Asian investors began looking for other wealth management options.

Stocks were beaten down, and investors sought new ways to grow their wealth. But what really pushed them into the direction of structured products was practical necessity – deposit rates were almost negligible.

In the aftermath of the technology bubble bust in 2000, US interest rates were cut to boost the world's largest economy. Singapore's deposit rates tumbled in tandem. In early 2003, for example, POSB savings and passbook account-holders got 0.125 per cent for the first $50,000. Today, Singdollar deposits at banks yield at least 0.25 per cent.

Typically, a structured product is a combination of a deposit and an investment product, and provides investors a return that is linked to the performance of some financial instrument such as shares or foreign exchange.

Retail investors can jump in with as little as $5,000. These instruments expire over the medium term – up to 10 years.

Banks swooped in with these instruments to satiate demand, and some were capital-guaranteed and promised to repay the investor the full sum that he ploughed in at the beginning.

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> **MR ELAN COHEN, JP Morgan Private Bank's senior portfolio manager**

Over the years, the structures became more complex.

One fund manager recalled how the Target 120 Protected Fund unveiled by DBS Bank in 2004 promised a 20 per cent target return and a fixed first-year payout of 10 per cent, with the remaining 10 per cent linked to the six worst-performing stocks in a selected basket of 24. No interest was earned, for example, if these six stocks fell by 20 per cent or more on average.

"Why would you invest in such a thing?" the fund manager asked.

But many did. While most retail investors did not understand how products like the Target 120 Protected Fund work, they were still drawn to the potentially higher returns.

Clever marketing helped, too, and some of these products were packaged to ensure enticingly high early payouts.

Early last year, before the subprime crisis reared its ugly head in this part of the world, the structured products industry was brimming with record sales. Consumers, aided by the feel-good sentiment of a booming economy, flocked in droves to buy them.

The industry is in a shambles now. Confidence among investors has been shattered. Angry investors say some of these products should never have been sold in the first place, and banks are unwilling to retest the waters.

"Markets always alternate between greed and fear, and right now, we're at maximum fear," said Mr Elan Cohen, JP Morgan Private Bank's senior portfolio manager.

"A year and a half ago, we were probably at maximum greed, so there was a proliferation of products to give investors exposure to equity markets."

With less demand and sales at a standstill, banks have had to improvise to cope with the times.

Some have restructured their operations, either laying off relationship managers or asking those lucky enough to still be on the payroll to sell other kinds of products such as insurance.

Industry players say the beleaguered industry will be revived, but the shape and form it will assume will be different.

Already, there are some clues as to the changes to come.

OCBC Bank and DBS have said they will introduce a cooling-off period to allow customers to pull out before they commit their cash to products. DBS said it will now preface every investment it sells with a summary sheet, and customers must affirm that they have read it.

"Training for staff will step up," said Mr Christopher Leong, partner at recruiter Chris-Allen Search.

"Bankers will be sent for training to improve selling skills, and to have better understanding of the products they sell, the risks involved and the legal and regulatory implications."

Meanwhile, the Securities Investors Association of Singapore has said it will work with institutions to establish a "risk rating" on all structured products on the market, as well as new products as they are released.

But this may not necessarily be a good thing, said Mr Leong of the Society of Financial Service Professionals. "Most investors are risk-averse, so if you take an extreme case, most people will end up buying the lowest-risk products and the lowest-risk ones will not beat inflation."

The key to managing risks and returns is not to reduce risks but to diversify one's portfolio with various classes of assets, he said.

Mr Rohit Jaisingh, who deals with equity risk management products at UBS, disagrees. Diversification is less important than suitability and appropriateness, he said.

"For a retired person, for example, it may be prudent to invest all his savings in low-risk products and not, for the sake of diversification, have funds invested in products where they assume a lot of risk to principal," he said.

Sure, there will be many more kinks to iron out and more issues to think about before the industry bounces back again.

Still, do not bet against seeing more investment products being sold in the future, because that will surely happen, experts say.

"I don't think innovation will suffer," Mr Cohen said. "If anything, there'll be more innovation about using derivatives and structures to give investors protection."

gabrielc@sph.com.sg