

Session F10

Structured Products: Another mis-selling scandal?

Kathy Byrne and Natalie Atkinson

9th November 2004

Headlines

Zapped by the men from Mazars

Mail on Sunday, 10th October 2004

More investors stare into financial abyss

Telegraph 28th February 2004

Precipice bonds bring down advisers

Daily Telegraph, 7th January 2004

Over the precipice

Daily Mail, 21st April 2004

Hope for victims of precipice bonds

Sunday Times 28th September 2003

Agenda

- Types of structured products
- Product Wrappers
- Lessons from history – how have products performed?
- Risk profiles
- Market trends 2000 vs 2004
- Sales trends

What is a structured product?

- An investment product that provides a return that is pre-determined with reference to the performance of one or more underlying markets
 - Performance depends on underlying and not discretion of product provider
 - Often use derivatives to generate the return
 - Typically two types
 - **Growth products** (may have capital protection)
 - **Income products** (provide a fixed high income but with risk to capital)
-

Payoff Types

- Digital
- Uncapped Call
- Capped Call
- Cliquet
- Reverse Convertible
- Geared Reverse Convertible
- Downside Cliquet
- Protected Tracker
- Portfolio Insurance
- Knock out call
- Exotic

What is a Precipice Bond?



Precipice Bond



**Reverse Convertible
(1 for 1 loss of capital)**

SCARPS

a product which provides an agreed level of income or growth over a specified investment period and ...

- the customer is exposed to range of outcomes in respect of the return of capital
- return of capital linked by pre set formula to performance of an index, combination of indices, a 'basket' of selected stocks ... or other factor
- If performance is within specified limits, repayment of capital occurs but if not customer could lose some or all of capital

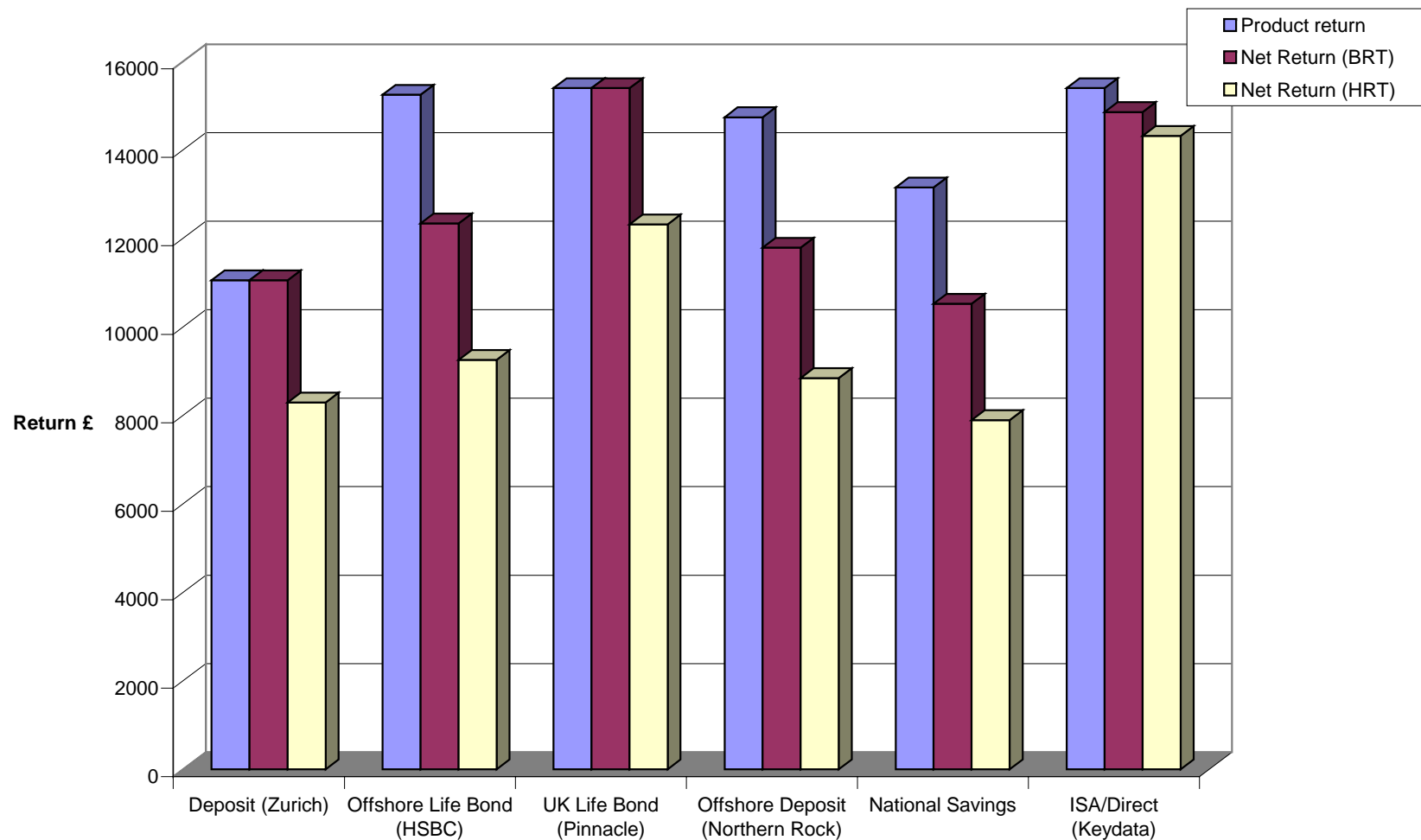
Product Wrappers

- Deposit
- Offshore Deposit
- National Savings
- UK Life Bond
- Offshore Life Bond
- ISA
- Direct equity investment/OEICs/Units Trusts
- SIPP/SSAs

Tax Position

Product Type	Benefits Quoted	Tax to Pay	
		Basic Rate Taxpayer	Higher Rate Taxpayer
Deposit	Gross	20%	40%
Offshore deposit	Gross	20%	40%
National Savings	Gross	20%	40%
UK Life Bond	Net	nil	20%
Offshore Life Bond	Gross	20%	40%
ISA	Gross	nil	nil
Direct Investment (Equities)	Gross	Dividends: nil Gains: CGT rules apply, Taper relief and annual CGT allowance used to offset tax	Dividends: 22.5%

Returns from £15,000 Investment

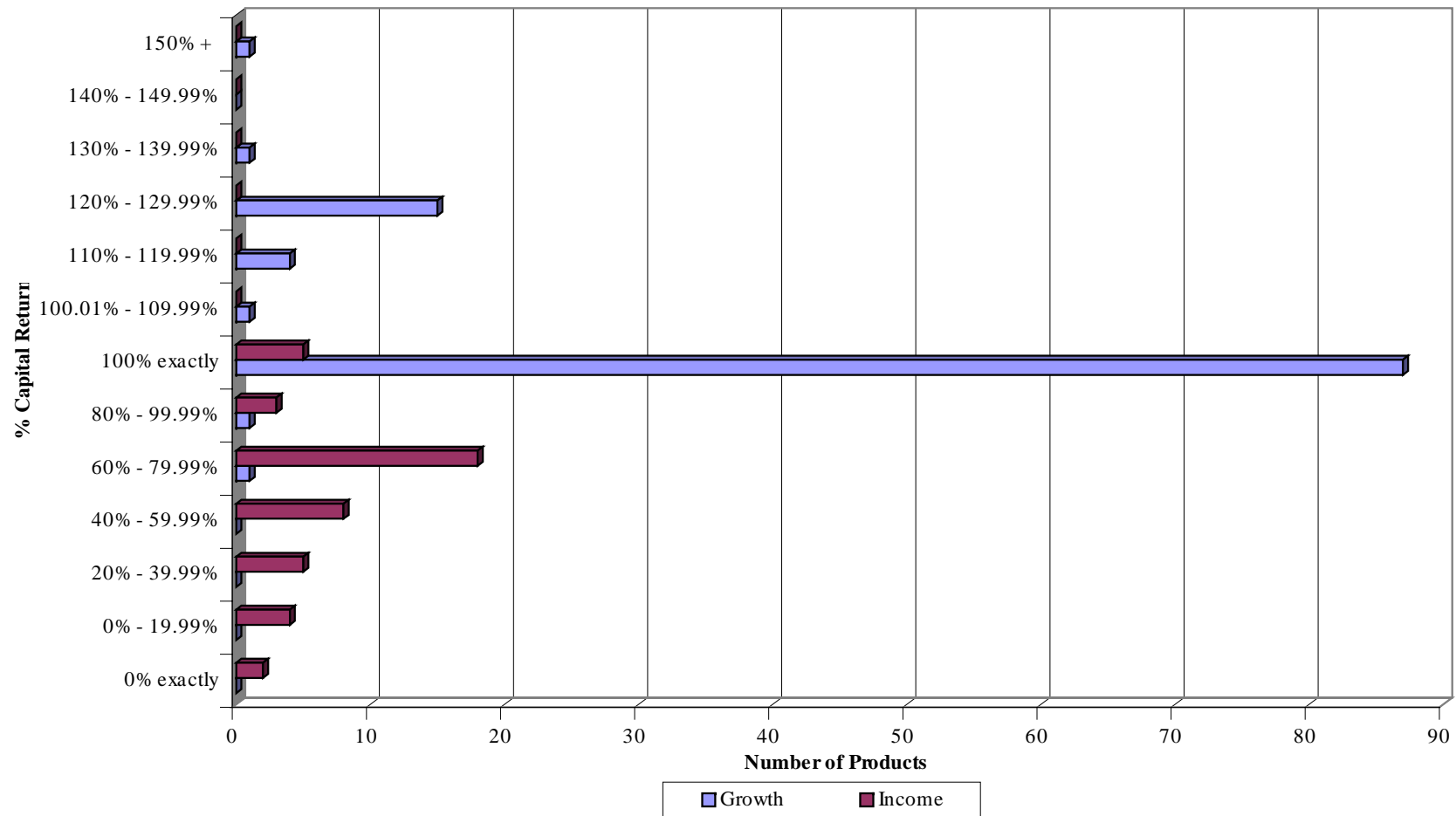


Source: Pinnacle Insurance plc research, www.structuredretailproducts.com
and product literature

How Have Structured Products Performed?

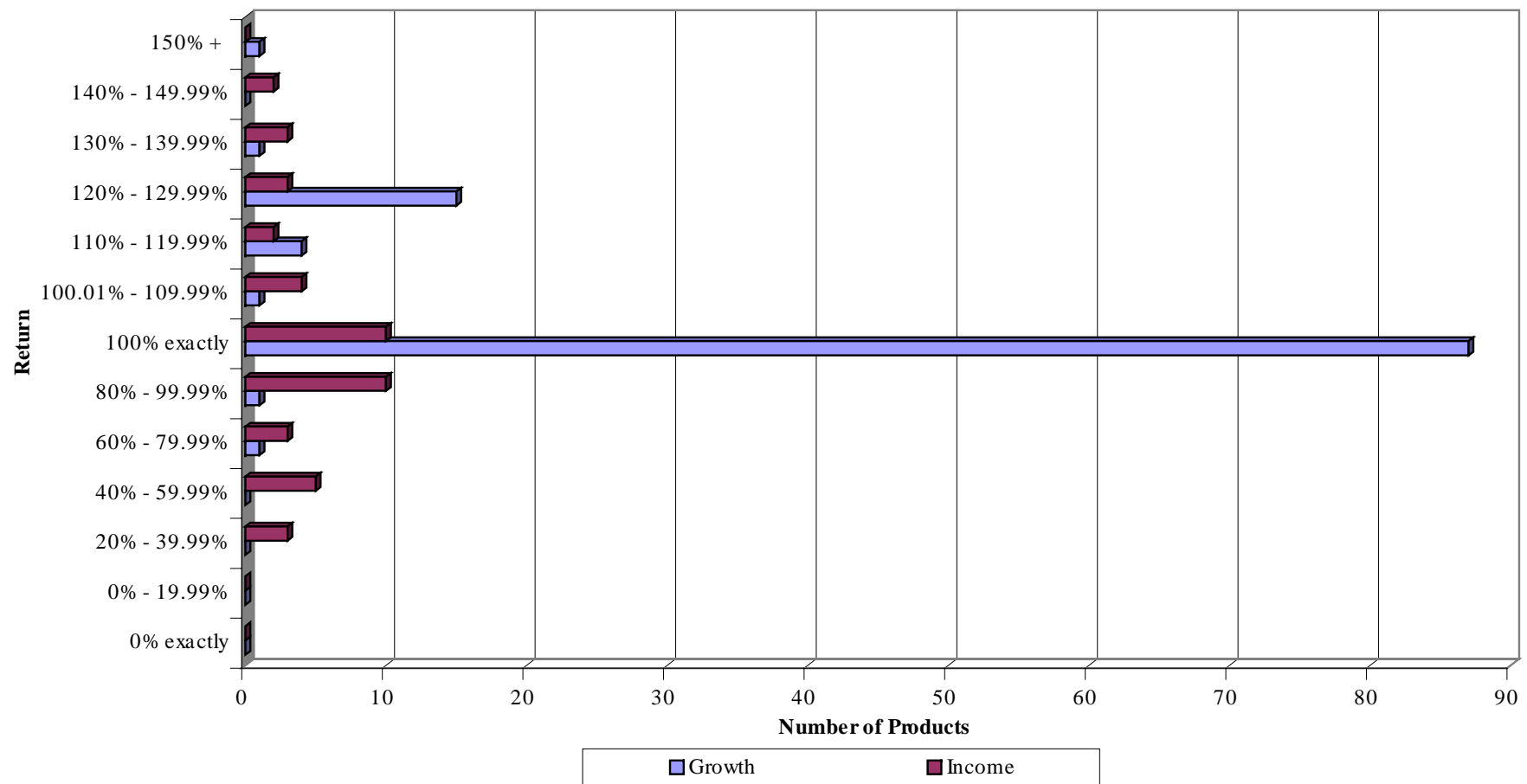
- Data sources: brochures, press, www.structuredretailproducts.com
- Identified 156 products maturing between 1/1/03 and 31/12/03
- Calculated actual returns if £10,000 had been invested:
 - Income & Growth products
 - Both capital returns and total returns

Capital Return



Source: Pinnacle Insurance plc research, data from www.structuredretailproducts.com and product literature

Total Return



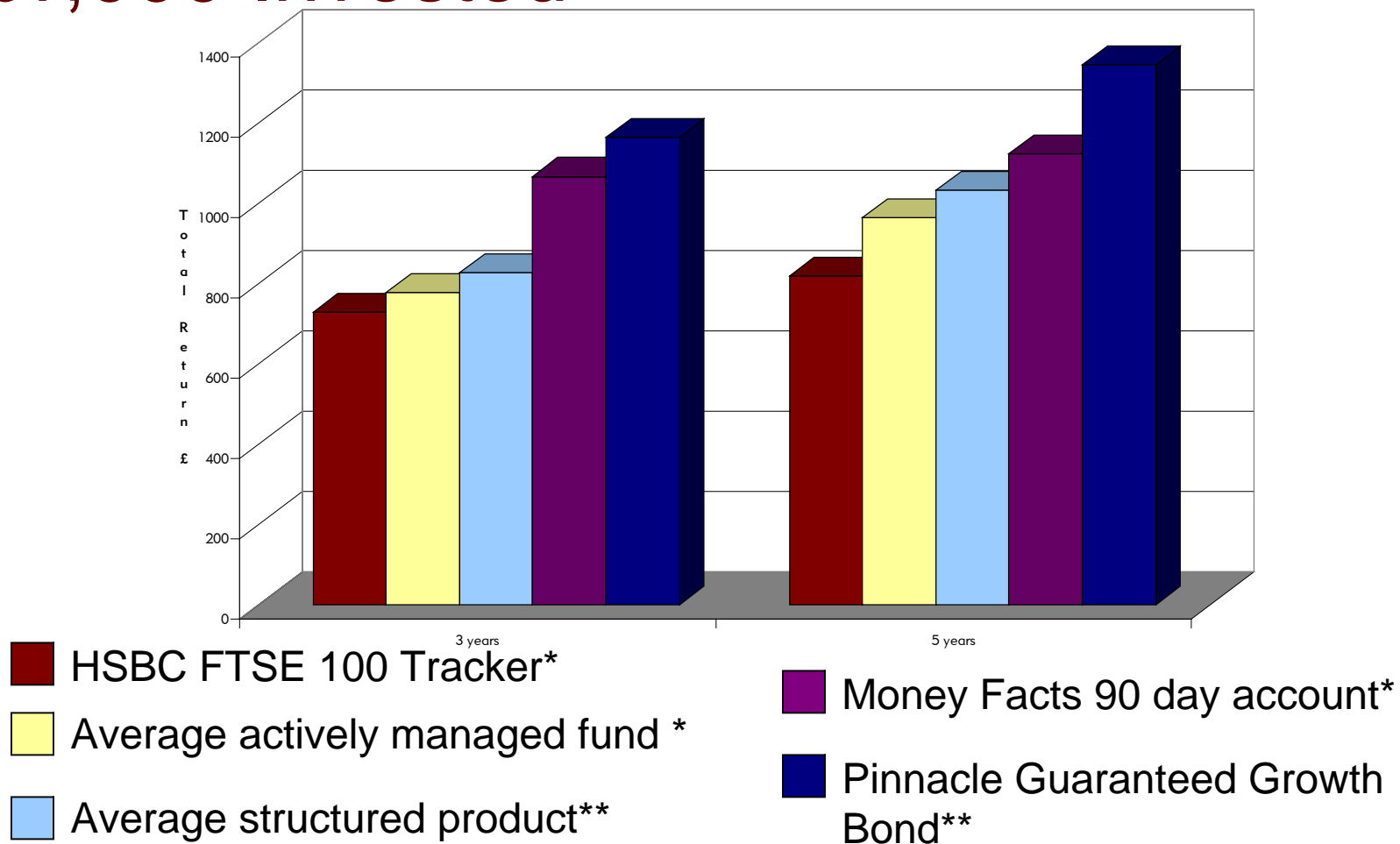
Source: Pinnacle Insurance plc research, data from www.structuredretailproducts.com and product literature

Structured Products Performance

- 40 products experienced some degree of capital loss
- Reduces to 23 when total return is considered
- 38 out of 40 are income products
- Two out of three best performing products are income
- 3 year products produced the worst returns
- 5 years or more produced the best returns
- Higher income => lower capital return

Performance against other Asset Types

£1,000 Invested



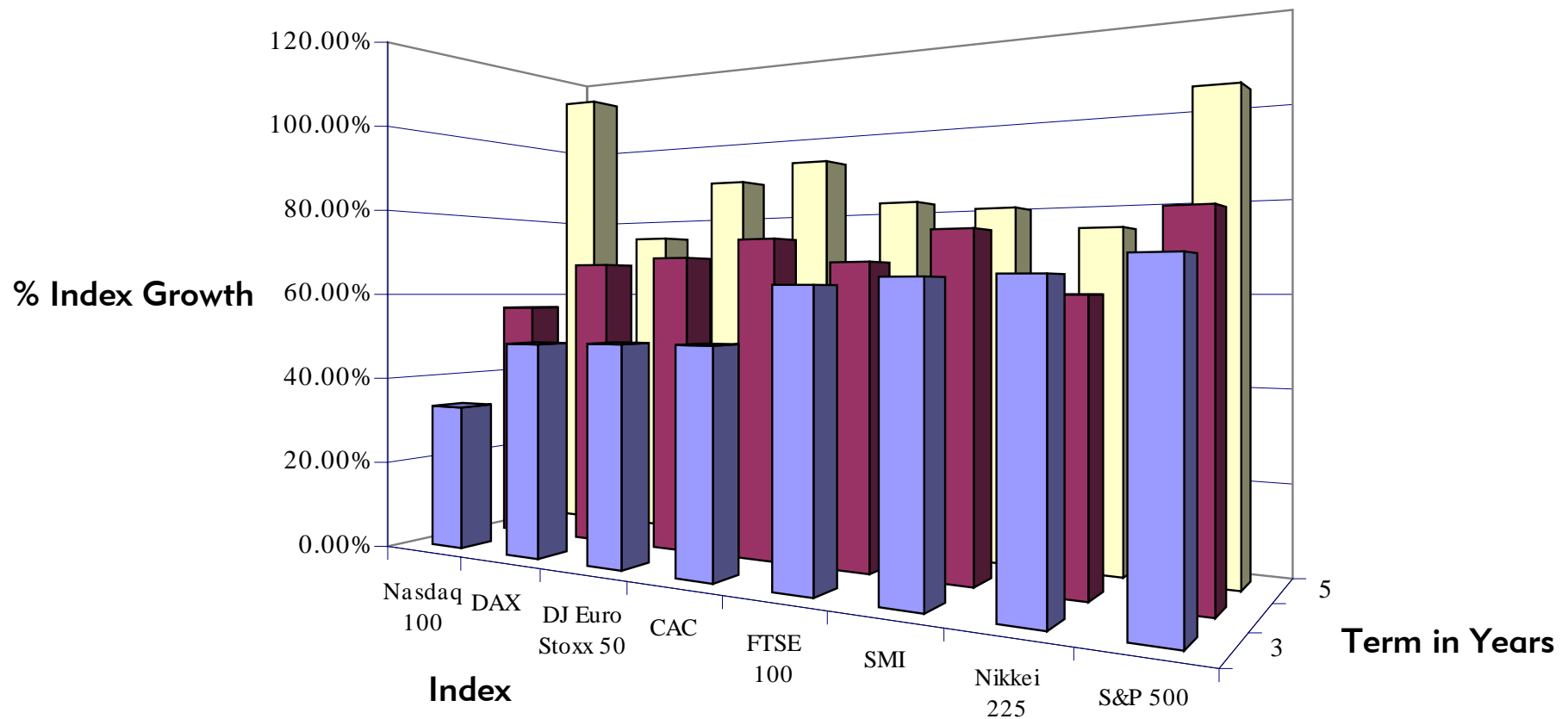
* Source: Money Facts Offer to bid, all income reinvested, figures as at 1/1/04

** Source: Pinnacle. GGB figures based on rates for min investment of £20k, figures net of basic rate tax

Risk Factors

- Term
- Nature of Link

Index Performance



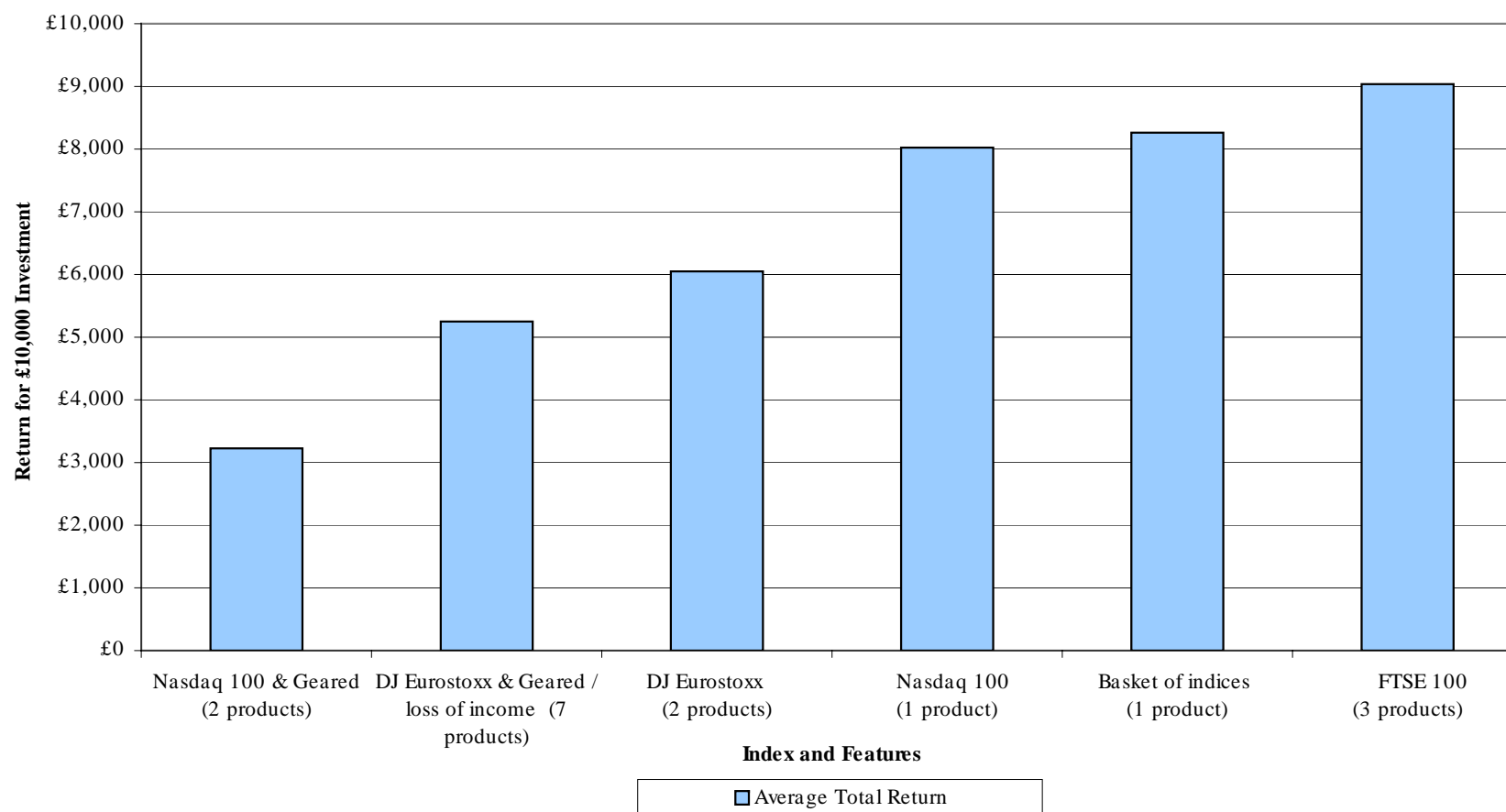
Source: www.yahoo.co.uk

Risk Factors

- Term
- Nature of Link
- Downside Risk

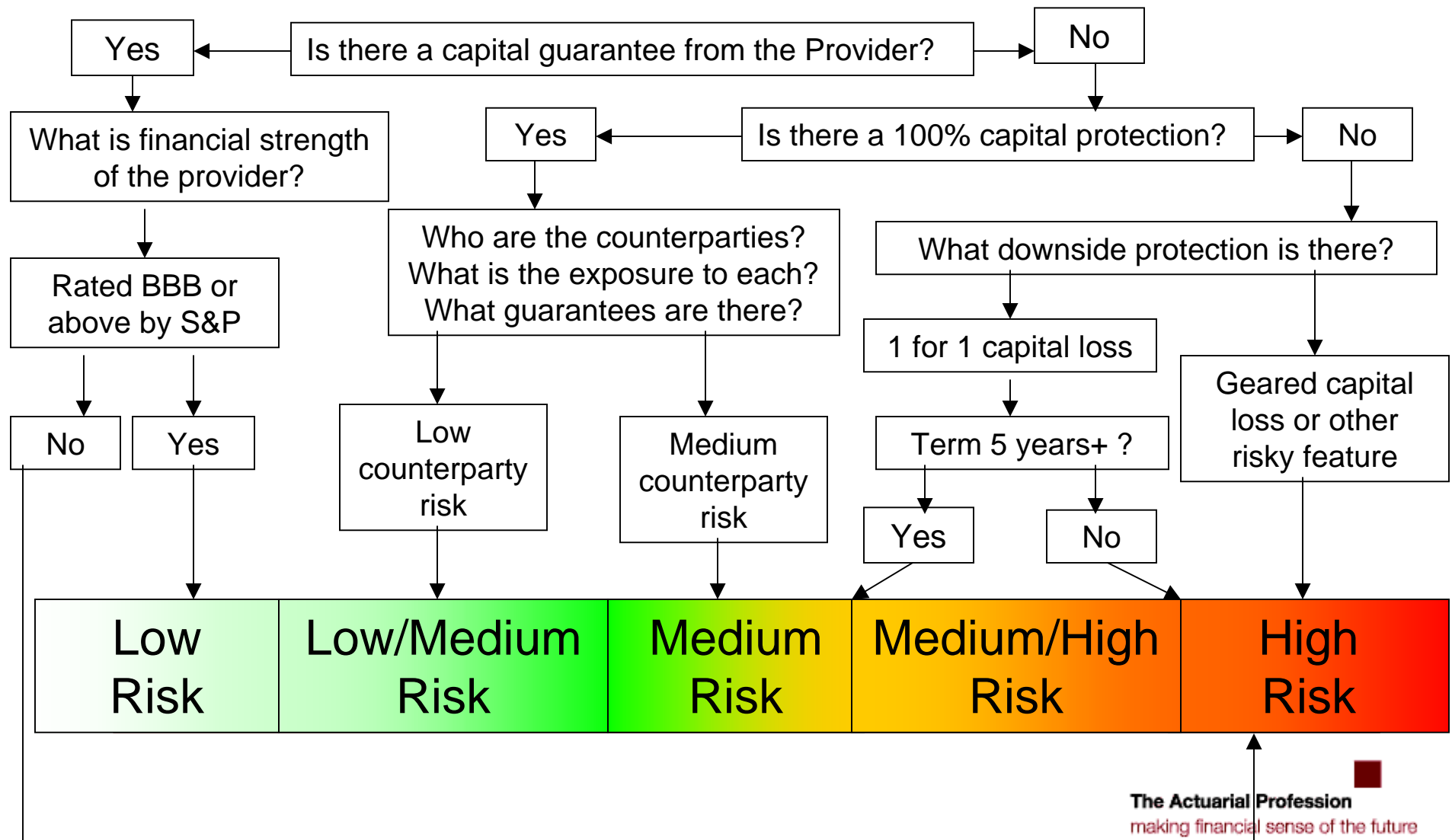
Returns by Product Feature

(3 Year Income products)



Source: Pinnacle Insurance plc research, data from www.structuredretailproducts.com and product literature

Overall Risk Assessment



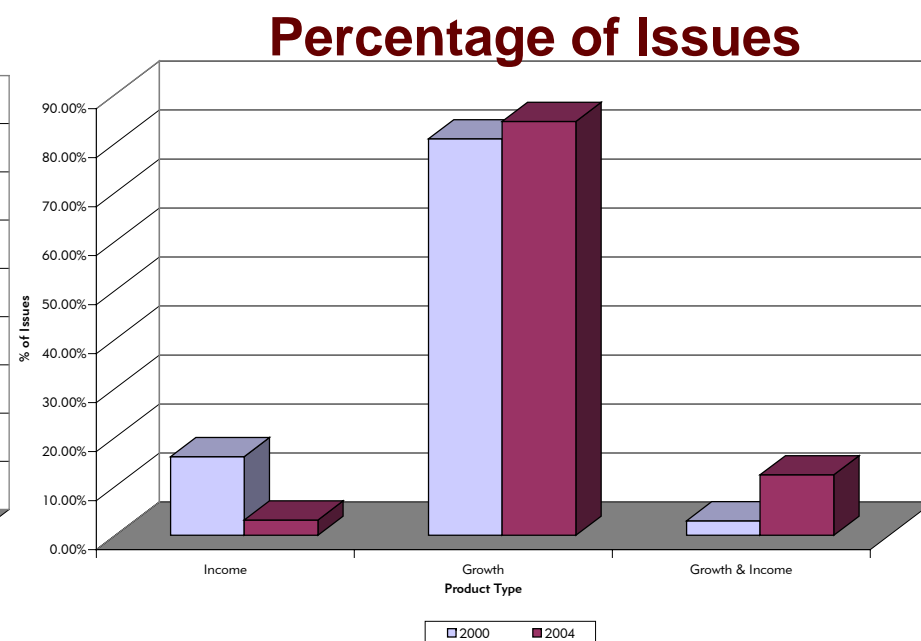
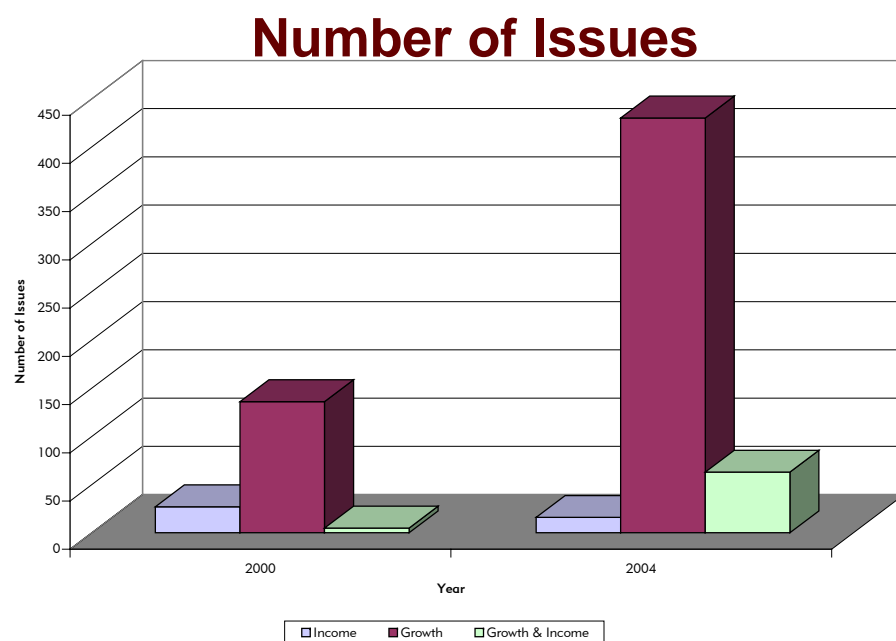
Summary – Risk and Return

- Consider both product and provider risks
- Risks assessment can be complex
- High potential returns usually mean high risk
- Look at returns net of tax

Market Trends

- 2000 vs 2004
- Number and types of issues
- Term
- Payoff types
- Wrappers

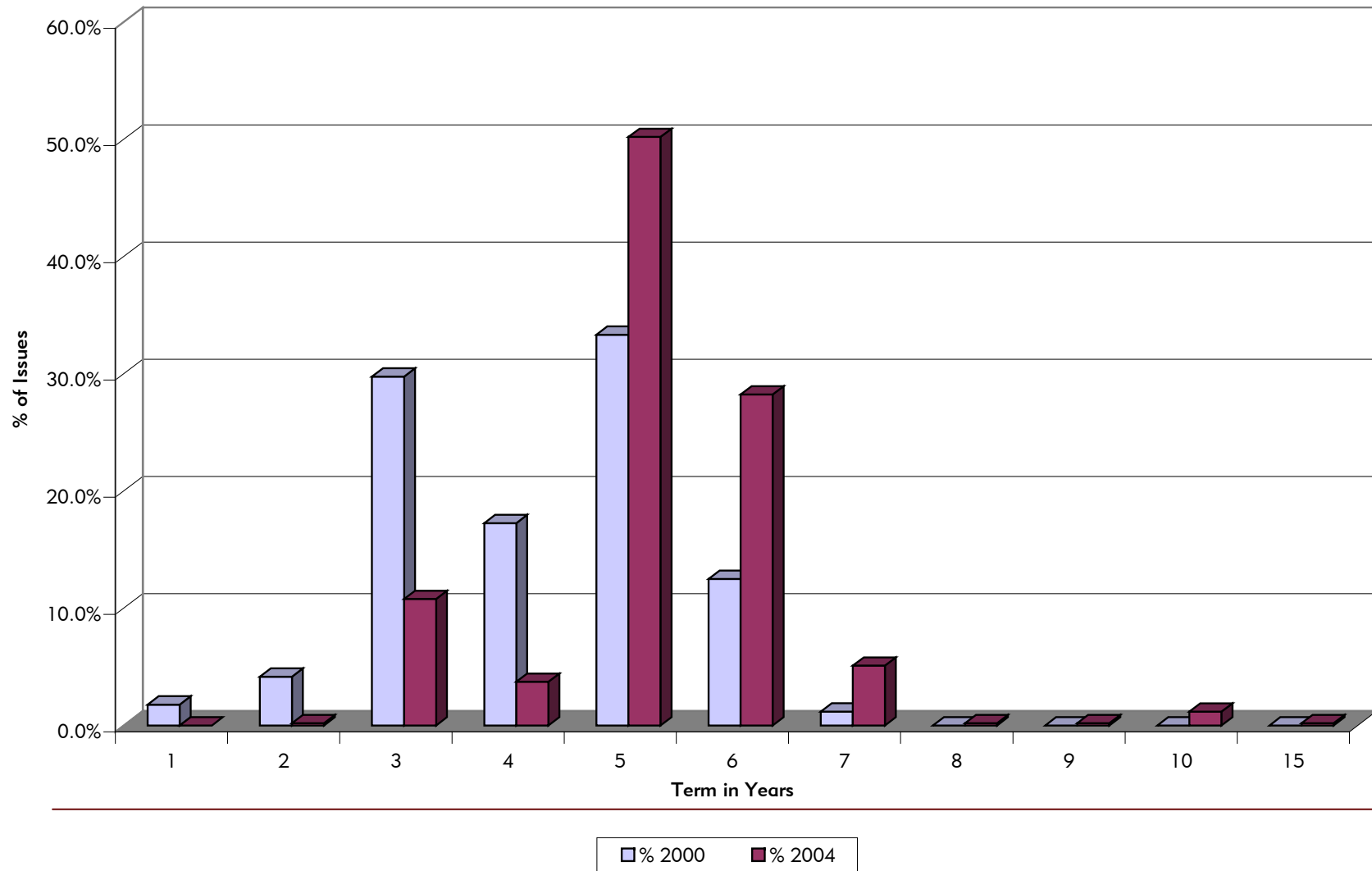
Number and Type of Products



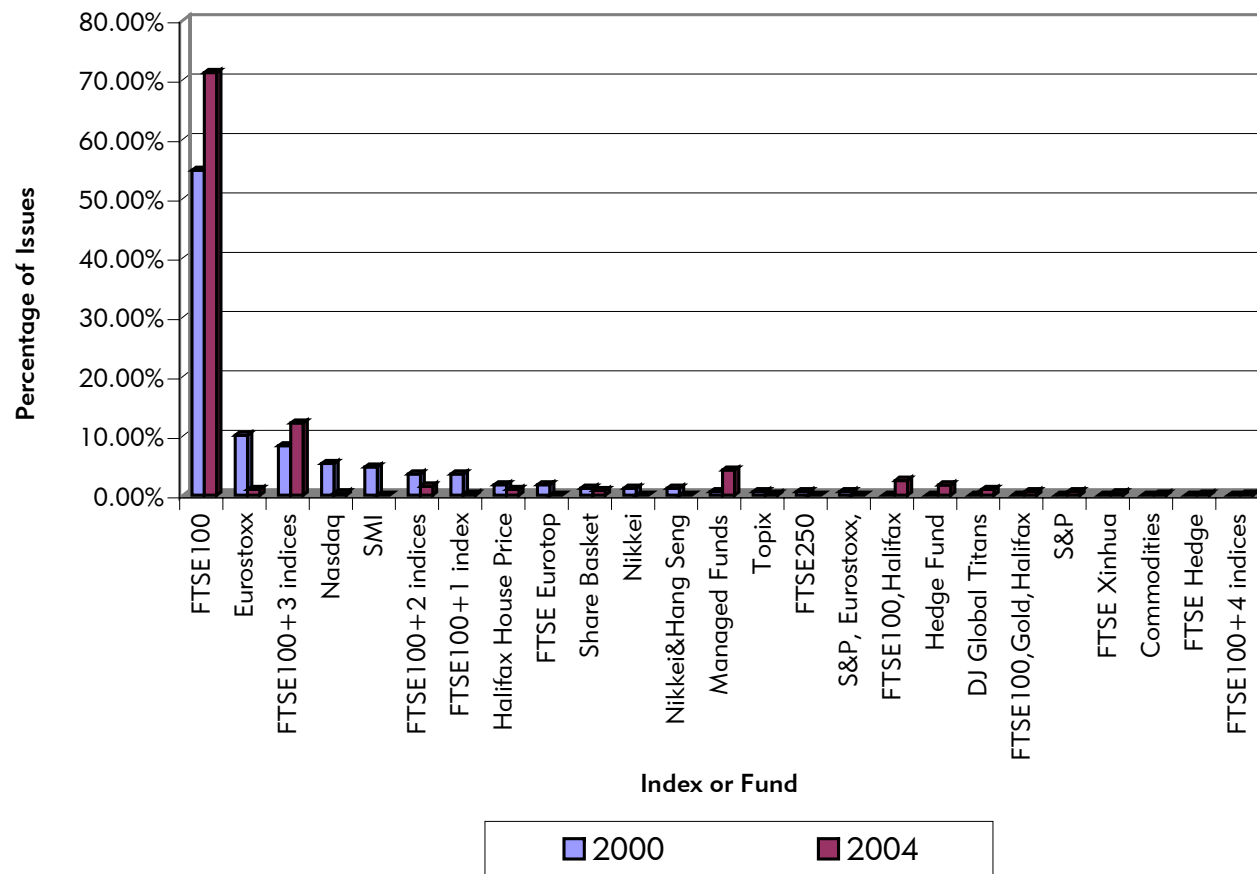
2000 168 products issued

2004 510 products issued

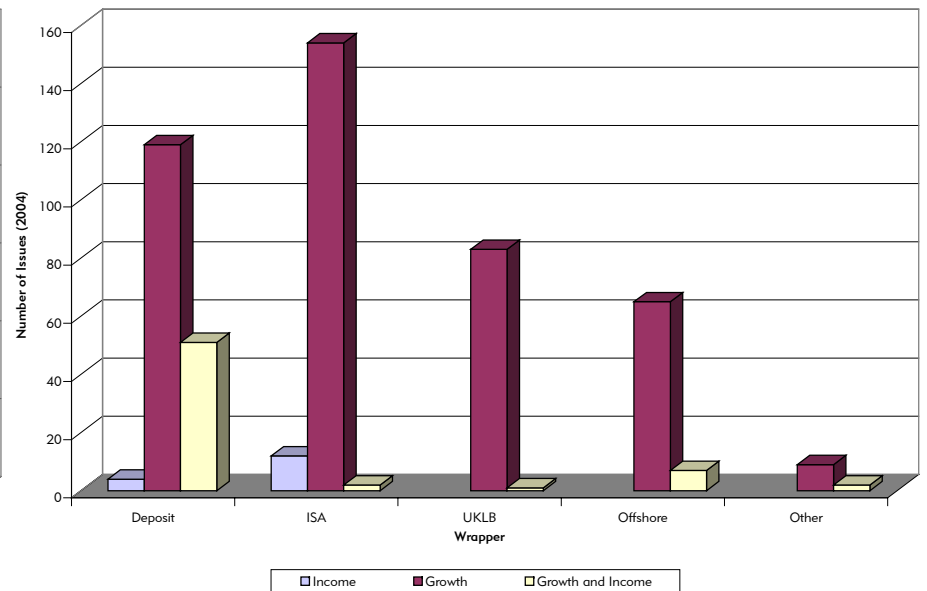
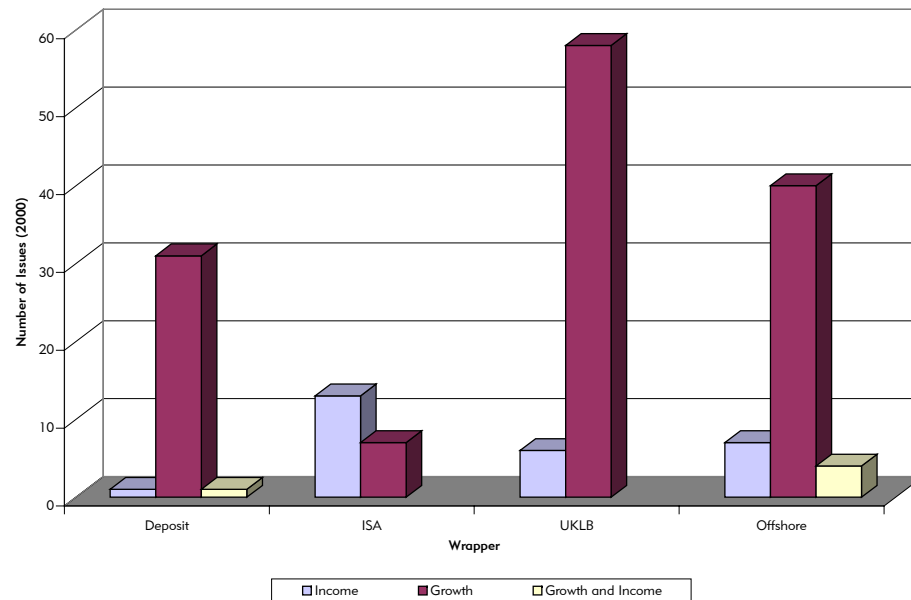
Term



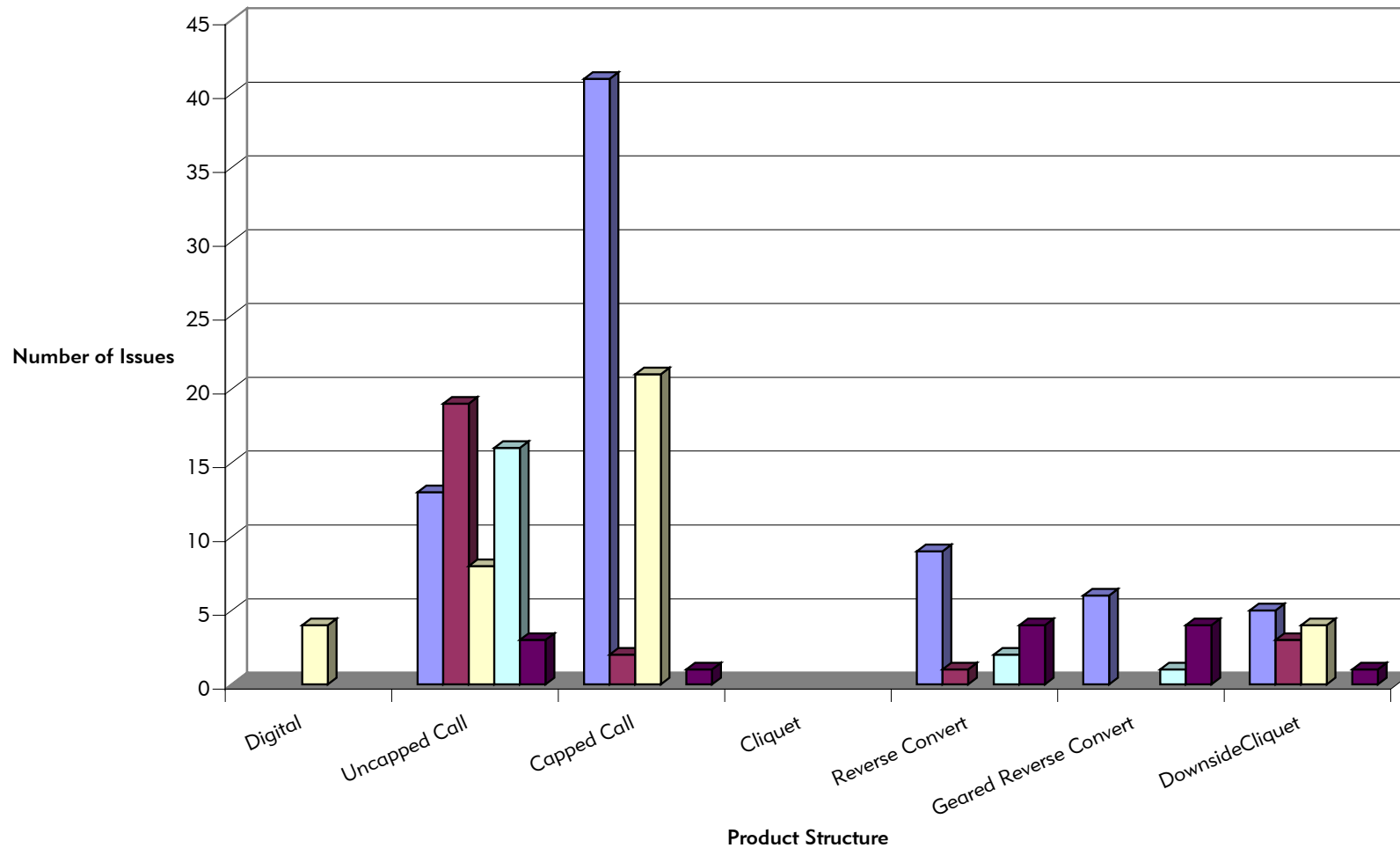
Underlying



Wrappers



Payoff Types - 2000



Life Co

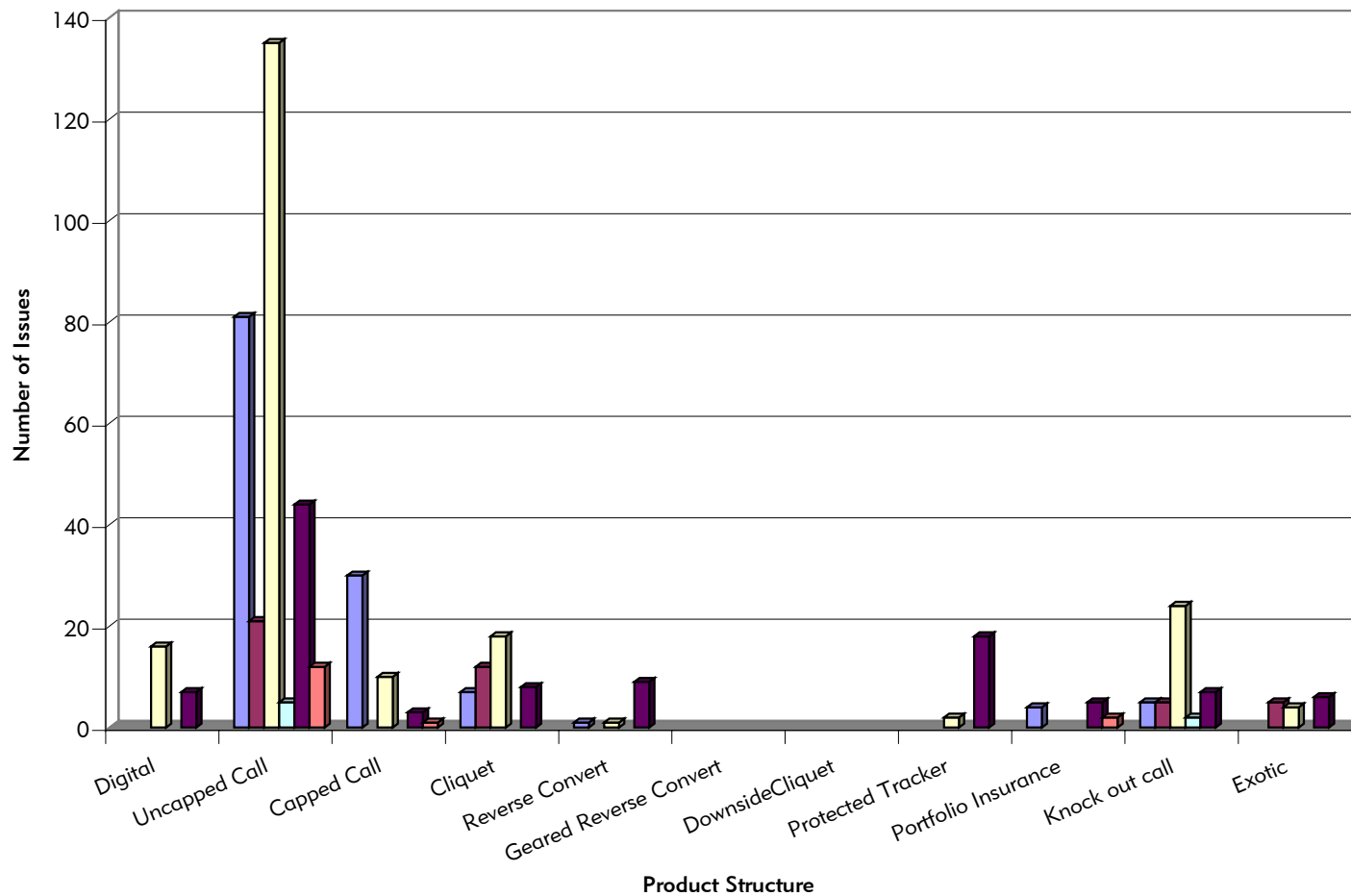
Offshore Bank/ Building Soc

Bank/Building Soc

Offshore Life Co

Fund Manager

Payoff Types - 2004



Life Co
Offshore Bank/ Building Soc
Bank/Building Soc
Offshore Life Co
Fund Manager
Offshore Fund Manager

Market Summary

- Many more providers and issues
- Term is longer
- Flight to quality
- Growth in ISAs
- Variety of product structures

Sales Trends

- Changes to literature
- FSA High Income Bond factsheet
- CP188 & PS04/3
- Advised vs Non-advised sales

Literature 2000

Plan Manager
NDF Administration Limited

**extra
income
& growth
plan²**

backed by
Abbey National Treasury Services plc

9.25% or **30%**
annual income for 3 years growth option

Full capital return unless stockmarket
falls by more than 25% during investment term
Capital not guaranteed

Tax free for
ISAs & PEP Transfers

SCOTTISH WIDOWS

*The Extra Income
& Growth Plan ISA*

10.25%
annual income
for three years

OR

33.00%
after three years
& two months


Offer must close by
6 December 2000
(22 November for
PEP transfers)

PREMIER BOND III

8.0%

each year for 4 years, free of basic rate tax
(equivalent to 10% p.a. gross*)

Monthly Income and Growth option also available
Offer closes 25th February 2000 or earlier if fully subscribed

 Pinnacle
Insurance plc

Canada Life's new investment opportunity
From 2nd May 2000 – must close 31st June 2000

Platinum Income Bond


You could enjoy

11%
gross per year, fixed
for the next 3 years

100% return of capital, even if the stock
market index has fallen by 20% at maturity

- Monthly income option 0.87% gross
- Growth potential of 35% gross*
- Subject to UK income tax
- Plus Early Investment Bonuses

*The maximum return is not guaranteed

 Canada Life

Administered by Canada Life International Limited
Registered by the Financial Conduct Authority for 10 years

Literature 2004

**NDF GROWTH PLAN
OCTOBER '04**

MUST CLOSE BY 2 DECEMBER '04

**PLAN MANAGER
NDF ADMINISTRATION**

PLAN INVESTMENTS ARRANGED BY
FISBEY FINANCIAL MARKETS,
AS INVESTMENT MANAGER TO THE
INVESTMENT COMPANY.

FULL REPAYMENT OF CAPITAL IS NOT GUARANTEED.

© DESIGNED TO DELIVER

Available from 04/10/04 to 12/11/04

Premier Growth Plan

Premier Limited Editions N° 22

- Potential **7% p.a.** growth on your capital for six years.
- Your capital is **NOT** guaranteed.

**Premier Asset Management
Access to Excellence**

**Pinnacle
Insurance plc**

The 21st Century Bond Issue II

**6 Year Investment
benefiting from the Growth
of FTSE™ 100 Index**

Limited Offer closes 5th December 2003

EXTRA INCOME PLAN

KEY DATA

Choose the level of income or growth that suits you best.

6.0% ANNUAL INCOME

1.41% QUARTERLY INCOME

33% GROWTH

ISSUE 12

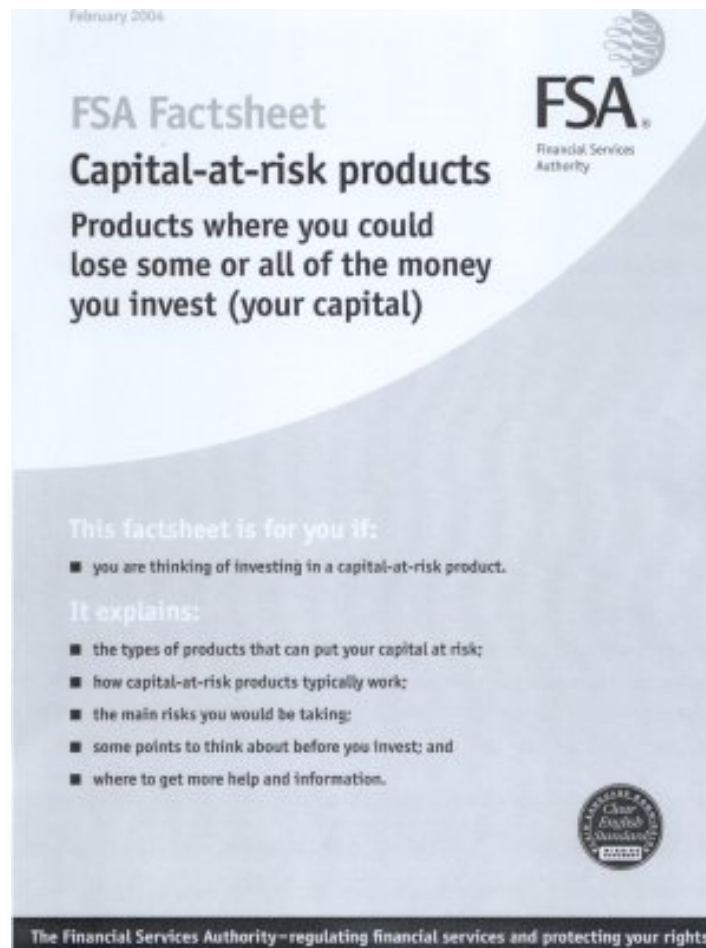
Offer must close on:
3 December 2004

POSTSA members can:
10 November 2004

Investment Period:
5 years

Account Manager:
Philippe Beaumont
Pinnacle Limited

FSA High Income Fact Sheet



CP188 & DP04/03

	1	2	3	4
Possibility of Capital loss prominent				
Headline Rates				
Counterparty Risk				
Cost of Guarantees				
Extent to which capital tied up at maturity				
Averaging				

Sales Issues

- Adviser responsible for advice (if any) given
- Non advised sales (execution only)
- Mailings
- Product provider responsible for literature
 - clear, fair and not misleading

Conclusions

- Majority of structured products performed well
- Current products have taken on board lessons from the past
- Structured products have range of risk profiles
- Vast range of competing products
- Move from execution only to advised sales