Integritas Financial Planners Ltd
Nurture · Grow · Protect

STRUCTURED PRODUCTS

What are they?

Structured products are a group of investments that are designed to deliver a known return for given investment circumstances and combine two or more underlying assets in order to offer growth or income potential, whilst usually offering some degree of capital protection Such investments normally share the following characteristics:

- Fixed term which means they are not as liquid as deposit accounts or investments in equities
- All of the return or interest only is linked to the performance of a stock market index/indices
- Offers enhanced returns because of the additional risk taken
- Offers growth or income options, or both
- Can be held within a variety of product wrappers including ISAs
- Varying degrees of capital protection may be available. For example, maximum loss being defined at outset or full protection given in all but extreme market conditions
- Tend to be offered for a limited period and for a limited amount of funds. The investment company will set a maximum amount that can be invested and once this level or the closing date is reached, the offer closes

There are two main types of structured product:

1. Structured deposit
2. Structured investment

Structured deposits and structured investment products with some capital protection are often purchased by those looking for alternatives to saving accounts and other deposit-based products.

These product offers growth that is linked to stock market performance – usually via an Index, such as the FTSE 100 Index, although the amount of return you may receive is sometimes capped.

Some structured products expose your capital to risk, although these plans are often set up with a ‘safety net feature’, which means that the stock market can fall by a certain percentage without affecting your capital return.

Other structured products protect your capital and are designed to return your capital whatever happens to the stock markets, these generally offer lower rates of return. The rewards or potential rewards offered by structured products are usually closely linked to the level of risk you are prepared to take. Many products offer you a choice of income (monthly, quarterly, annually) or growth and this is often a fixed percentage in each case.

You should carefully assess the potential rewards against the risks you will be taking. For example, you may be offered a fixed income for a period of time but with the risk of losing some, or all, of your capital. Or you may be offered capital security with lower potential returns.

The “safer” a plan is, the lower the potential rewards tend to be and the reverse also tends to be true. It is important to remember that you might get more by investing directly in the stock market if it is a rising market although you would not get any protection from any falls.

Some structured deposits and investments include the word ‘guaranteed’ in their name – you should check what element of the product is guaranteed as limitations may apply.

Structured deposits

These are sometimes referred to as ‘capital guaranteed’ products as they guarantee the return of original capital at maturity.

Structured deposits are savings accounts, offered from time to time by banks, building societies and National Savings & Investments, where the rate of interest you get depends on how the stock market index or other measure performs. If the stock market index falls, you are unlikely to get any interest at all. Structured deposits generally require you to tie up your capital for a set time, often five or six years in return for a lump sum at maturity. The interest you earn depends on how well something else performs – often a stock market index such as the FTSE 100.

However, unlike structured investments, the capital you originally invest has the same protection as any other savings account.

Structured investments

These are sometimes referred to as ‘capital at risk’ products as they do not guarantee capital repayment at maturity.

Structured investments are commonly offered by insurance companies and banks. Your money typically buys two underlying investments, one to protect your capital and another to provide the bonus. The return you get depends on how the stock market index or other measure performs.

When you buy a structured investment, you also agree to tie up your money for a set period. Some of these products offer you a lump sum at maturity depending on the performance of the stock market index or other measure.

Other structured investments let you take a regular income and whether or not you get back your original investment in full, depends on how the stock market index or other measure has performed. If the stock market falls, you can lose a very large chunk of your original investment.

Counterparty risk

The counterparty issues financial instruments and assets which are intended to deliver the investment returns for the structured product.

Your money is invested in a Medium Term Note which is a type of Corporate Bond, which is a loan to a company. However, there is a possibility that the company could fail. In the unlikely event that the Note Provider defaults or becomes insolvent, your investment would be at risk and you could lose some or all of your investment.

You will be advised of who the counterparty is, prior to making any investment.

Capital risk at maturity

Some structured products include a form of capital protection. Generally there are two types of protection available as follows:

- ‘Hard Protection’ is where the minimum return is fixed regardless of the underlying investment performance
- ‘Soft Protection’ is where the minimum return will only be achieved if the underlying investment maintains a certain level. If it does not, the capital protection may be lost in part or completely

The capital protection often takes the form of a bond from the financial counterparty to the structured product and this is usually an investment bank or some other form of large financial institution. The strength of the protection will depend on the counterparty’s ability to meet its financial obligations at the end of the investment term of the structured product. Assessment of the counterparty is based on a number of factors which include credit worthiness (using independent credit ratings) and financial analysis (e.g. financial statements and financial ratios) as well as assessment of management (experience and commitment) and market opinion.

Eligibility

The majority of structured products offer three ways of investing:

- Direct investment
  You invest capital into the product direct
- ISA
  You invest into the product using an ISA wrapper and receive the same tax benefits you would by investing in an ISA.
- ISA transfer
  You can transfer from a cash or stocks & shares ISA to a structured product held in an ISA wrapper. You can choose to transfer all or part of your ISA savings.

In addition, some plans also offer an option to invest via a designated pension wrapper such as a Self-invested personal pension (SIPP).

Contribution limits

There are no specific limits on the level of investment other than those that may apply to the wrapper (i.e. ISA or SIPP) for the investment. Also, providers may set their own minimum levels of investment per application.

Taxation

Normal tax considerations apply where the product is held outside of a tax wrapper e.g. ISA or pension plan.

Most growth plans are designed in such a way that you may have a CGT liability at maturity but you could of course still make use of your Annual Exempt Amount. Any excess returns would be subject to CGT at 10% for taxable gains falling in the basic rate band when added on top of income or 20% on gains (or parts of gains) that fall above the basic rate band. Any losses can be netted against other gains for the tax year.

Returns from income plans are normally subject to income tax. The income distributed may be gross or net of basic rate tax depending on how the plan is structured.

Income from the corporate bond is paid gross of tax. Taxpayers who invest outside of an ISA will be liable to pay income tax at their highest marginal rate, usually via their annual tax return.

Non taxpayers (after addition of the income from the bond) should have no tax liability.

All individuals have a £500 per annum dividend allowance and dividends up to this level are tax free. Dividends over £500 are taxed at:

- 75% on dividend income within the basic rate band
- 75% on dividend income within the higher rate band
- 35% on dividend income within the additional rate band

If the investment is within the ISA option, income is free of taxation.

All statements concerning the tax treatment of products and their benefits are based on our understanding of current tax law and HM Revenue and Customs’ practice. Levels and bases of tax relief are subject to change.

Risk considerations

There are a number of risk considerations that need to be taken into account. It is important that you are aware of these.

Relevant to both structured deposits and structured investments:

- Structured products often have complicated features that can make it difficult to understand the return you are likely to get.
- As structured products are linked to an index, the underlying index may fall significantly at the end of the term resulting in you suffering a financial loss and that there is no facility to manage the investment to reduce exposure to falling markets.
- If you are forced to realise your capital before the maturity date, you may get back less than the amount you originally invested and may be subject to early redemption penalties.
- Fixed-term products cannot be cashed in according to market sentiment.
- Past performance is no guarantee of future returns, and the final level of the relevant Indexmay be lower than the initial level.
- Inflation will reduce what you can buy in the future.
- The tax treatment of structured products could change at any time.

Specific to structured investments:

- Some structured investments offer a degree of capital protection while others do not. The income or growth is usually not guaranteed and you may get no return on your investment. Even where there is capital protection, the deduction of fees and charges could mean you could get less than you put in, particularly if terminated early.
- If the relevant stock market index or other measures performs badly, you may lose some or all of your original investment.
- If the firms providing the underlying investments fail, you may lose some or all of your original investment.
- You may not be covered by the protection offered by the Financial Services Compensation Scheme.
- You must be prepared to accept some risk to your capital to achieve the potential returns being offered. You should not enter into the transaction unless you are prepared to lose some, or all of the money you want to invest.
- The perceived creditworthiness of the issuer may affect the market value over the term. Furthermore if the issuer fails to meet its obligations, you may get back less than is due to you or nothing at all. Any income payments may also be affected.
- The closing level of the Index is calculated on a capital return basis. It does not take dividends into account.
- Your investment could end and be paid out before the stated term if a particular event occurs, for example, the relevant index rises above a predetermined level. This is often referred to a ‘kick-out’ or ‘auto-call’.
- Your investment will be subject to counterparty risk. The level of this type of risk will be dependent on the provider of the structured investment – not on the underlying investments.

Specific to structured deposits:

- Structured deposits are not like typical deposit accounts. The level of interest payable is dependent on how well something else performs – often a stock market index such as the FTSE 100. Depending on the performance of the relevant index, you could receive no interest payments at all for the whole term of the plan.