Silencing the critics

Richard Eagling reports on how the structured products sector is continuing to deliver strong returns and proving the sceptics wrong

Constructive criticism is of course, part of life, but where structured products are concerned, many of the negative headlines that the sector has generated over the years have been unfounded or completely misleading. From the Investment Management Association to former Hargreaves Lansdown Chief Executive Peter Hargreaves, there was a time when there was seemingly no shortage of high profile names queuing up to attack structured products.

The unreported success story

While these negative views received plenty of newspaper column inches, by contrast, there has been precious little coverage of the way in which the structured products sector has improved and evolved over the last decade, and its consistently impressive investment performance. "With few exceptions (notably Moneyfacts for one) the success story has gone almost completely unreported," points out *Ian Lowes, Managing Director at Lowes Financial Management*.

This dearth of positive reporting is particularly disappointing given the mounting evidence of the ability of structured products to deliver strong returns. Research of the UK retail structured products market for the period 2010-19 published by Lowes Financial Management, revealed that just 60 (1.54%) of the 3,895 products that have matured so far have returned a loss. Over the last decade, the average annualised return from capital-at-risk structured products was 7.84%, followed by an average annualised return of 5.56% from income plans and an average annualised return of 3.64% from deposit-based structured products.

"Structured products are forever changing to better meet the needs of clients in whatever the prevailing market may be, and the performance of structured products over the last 10 years has been impressive, giving many alternative investments a run for their money," says *Zak de Mariveles, Chairman of the UK Structured Products Association.*

Where losses have materialised, analysis by Lowes Financial Management suggests that a number of clear characteristics can explain these failures. Firstly, in some cases the loss-making products were launched before the 2008 financial crisis, so suffered from its impact, while in three cases the structured products were restructured by the provider to protect against potential counterparty default, which led to a loss.

Another characteristic of loss-making structured products was that they used an American capital protection barrier rather than a European barrier, which meant if the index fell below a certain point during the investment period, capital was lost. According to Lowes, if a European barrier, which is measured at the end of the investment, had been used instead, a loss would have been avoided.

Other attributes shared by loss-making structured products include the use of an alternative single index, such as the Euro Stoxx 50, or Nikkei 225 and an American barrier, or a link to emerging market or oil indices. Some loss-making products were also share-linked plans or linked to baskets of commodities.

The good news, however, is that the structured products sector appears to have learned from these failures and made improvements to the product proposition. "Our analysis shows why certain products produced losses and where changes needed to happen to make structured products more investor and adviser friendly," says Ian Lowes. "Change has occurred. The current market has moved away from the characteristics highlighted, such as American capital protection barriers and baskets of individual stocks. These days, the majority of products have the familiar FTSE 100 as the underlying benchmark and they use European end-of-term capital protection barriers."

The rise of capital-at-risk plans

The Lowes report also reveals that the issuance of capital-at-risk products, where plans aim to return investors' capital in all but the most dire market conditions, has proliferated over the last 10 years. Capital-at-risk plans accounted for 81% of the plans issued in 2019, 26% more than in 2010.

The increased issuance of capital-at-risk products is in contrast to the decrease in capital-'protected' products, which have gradually been phased out during the decade due to issues around their technical construction. In 2010, 74 capital-'protected' products were issued (accounting for 15% of the plans issued), but since 2015, only one such plan has been issued, with capital-at-risk products becoming the industry norm.

"Probably the most obvious change has been a move away from the structured deposits offering full capital protection if markets fall, to those products that fully protect capital from market falls so long as markets do not fall significantly over the life of a product, typically around 50% over a five/six-year period," says Zak de Mariveles. "There has also been a focus on offering simpler product payoffs, with very clear, fair and not misleading literature, helping to ensure that structured products are appropriate to the widest possible number of UK retail investors."

Autocall popularity

Over the last decade, there has been a marked increase in the amount of capital-at risk autocall or kick-out plans, reflecting their rise in popularity. Indeed, by 2019, 78.7% of the capital-at-risk plans issued were capital-at-risk autocalls.

"While there have been many variations, the mainstay of the UK retail structured products sector has become the FTSE 100-linked capital-at-risk autocall," says Ian Lowes. "Data from our StructuredProductReview.com tells us that since the first was launched back in 2003, there have been just short of 1,000 such products mature. The average annualised return from all these has been over 8%, but what's more telling is that just eight failed to produce a gain. Had these eight had maximum durations of more than six years, only one would have failed to mature positively."

The appeal of autocalls is not difficult to understand, given that they provide multiple opportunities for the product to mature and therefore produce a gain if pre-defined performance conditions are met. The longer it takes to trigger a maturity, the greater the potential gain.

"Autocalls give investors something to focus on in terms of maturity triggers," says Ian Lowes. "If these are missed, it's not bad news, if they're not missed, its good news. The price you pay for capping returns in terms of the capped autocall coupon has been money extremely well spent and I expect it will continue to be going forward – if I'm wrong, the investments will still do exactly what they were defined to do from the outset."

Longer maximum durations

Another significant change to the structured products market over the last decade has been the introduction of longer maximum terms beyond six years. "There has been a move to longer duration autocalls, which has repositioned market risk, as their maximum investment term is eight-10 years rather than five-six years previously, which means they are far more likely to deliver a positive outcome for investors," says Ian Lowes.

The Lowes research clearly demonstrates this trend, with 83.8% of capital-at-risk autocall plans issued in 2019 having a maximum term longer than six years, compared with just 1.7% of plans in 2010.

"Longer maximum durations are now commonplace since we introduced the concept back in 2015 with the first 10:10 Plan," says Ian Lowes, "At all times we were hoping that they wouldn't be necessary but they were there, just in case we suffered a Black Swan event of the likes we have witnessed this year. If markets take several years to recover, some of these longer duration autocalls could transpire to be among the best-performing investments as the returns increase for each year that they are in force, even if the stock market doesn't. So those that were invested in last year should hopefully come good in the end and those invested in this year, will still benefit from the defined returns and peace of mind the structure affords."

Further innovation

Even during the COVID-19 pandemic, the structured products market has been innovating. A good example is the new 10:10 Income and Growth Plan launched by Mariana UFP and Lowes Structured Investment Centre, which offers quarterly income plus an autocall for growth. It also uses the FTSE CSDI as its benchmark rather than the FTSE 100, which enables it to offer more favourable terms.

"There are two more major developments that I'm proud to say we played a part in helping to bring about," says Ian Lowes. "These are the introduction of combined income and growth solutions and the use of the FTSE CSDI index, which is 99% correlated with the FTSE 100 Index but helps structurers overcome the issue of variable and unpredictable dividends while passing the risk and cost-saving for such onto the investor for what I see as an all-round mutual benefit. I expect to see both of these become mainstays of the sector going forward."

Adviser attitudes

But it is not just the structured products themselves that have evolved over the last decade, adviser attitudes to them are also changing.

"As more and more empirical evidence is made available, more advisers are starting to recognise that the structured products sector offers something that is very valuable," says Ian Lowes. "Sitting as satellites alongside traditional portfolios, their defined outcomes give the clients something tangible to focus on. We encourage them to do so while avoiding the daily noise of the markets and the rest of their portfolio. When the structured products eventually come good, they can't fail to meet expectations. Given the shape of most autocalls, if they don't ultimately come good, we've all got a lot more to worry about in terms of general investment market performance."

The growing recognition of the value of structured products among advisers can be seen in the results of a recent survey conducted by StructuredProductReview.com. It found that 75% of the advisers surveyed agreed that in the main, structured products have proven to be good investments. Nearly half of respondents also said that they strongly agree that structured products are generally a lot easier for investors to understand than they have been given credit for. In terms of their usage, 87.9% of respondents said that they, or their firm, utilise structured products at least "occasionally", with 50% using them "frequently". By contrast, just 12% claimed that they "never" use structured products.

"The use of investment products that offer a degree of protection against market falls, and where the performance is clearly defined at the outset, can help many portfolios change their risk profile to be better suited to the investor's needs and the current uncertainty that surrounds many markets," says Zak de Mariveles. "It comes as no surprise therefore that interest from the advisory market in the UK for structured products remains strong, especially with products offering to generate positive returns even when markets are falling, and providing an alternative to the more traditional absolute return funds that have struggled to perform in recent years."

Better provider support

It is also fair to say that the support offered by the structured products sector is helping to improve adviser understanding of this market. "Advisers will, rightly so, only advise those investments they are familiar with and understand, and some lack the time or the desire to keep up with the many changes that have happened over the last decade in structured products," says Zak de Mariveles. "What is clear is that there is a wealth of educational material and tools available for advisers to help them on their journey."

An excellent example of this is the Portfolio Optimiser tool, which was introduced by the UK Structured Products Association in March 2020. This portfolio analysis tool allows advisers to see how structured products can complement and enhance a wider investment portfolio, and impact the expected performance and risks.

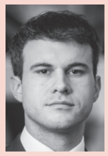
"The recent launch of the UKSPA Portfolio Optimiser tool has helped advisers to review their clients' existing portfolios and analyse how the use of specific structured products can benefit a client's overall portfolio in terms of expected risk returns, providing an independent analysis as part of any suitability review," explains Zak de Mariveles. "This free to use service, combined with the various other services provided by the UKSPA to advisers, such as a search tool to view what products are available in the advisory market (along with all the required supporting literature), and education videos to help better understand how various product payoffs work, has proved a useful tool for any adviser who wishes to offer their client a professional whole of market advisory service."

Time to shine

It is clear that structured products have come a long way over the last decade and are starting to silence the critics that had unfairly labelled them "confusing, complex and costly", to name just a few of the criticisms. For too long there has been a real danger that this distorted picture of structured products could prevent investors from considering the important role that they can play in a diversified portfolio.

Furthermore, with historic low interest rates continuing to put pressure on savings rates and bond yields, and the heightened equity volatility making investors increasingly nervous, the ability of structured products to offer pre-defined returns and limit potential capital losses, should enable them to shine.

"These are unprecedented times, both in terms of the rates available on savings accounts and the uncertainty that comes with equity investments," says Zak de Mariveles. "The Bank of England base rate is the lowest the UK has ever seen, meaning investors are facing low to zero returns on their savings. And with the recent announcements by National Savings & Investments (NS&I) to slash its returns, it's easy to see why investors are in need of alternative investment solutions. Structured products can offer potential returns linked to equity markets that can be far in excess of current savings accounts, some not requiring markets to rise at all, often while protecting your capital against losses even with moderate falls in equity markets."



Structured products: Provider perspective

Michael Last, Head of Plan Management at Investec Structured Products

Q To what extent do you feel that the current testing investment environment and heightened stock market volatility will provide fertile conditions for boosting the appeal of structured products?

A For the next three to five years, the only certainty is uncertainty; products and portfolios that are designed to perform in a broad range of market conditions should benefit from this environment because they will give the greatest peace of mind to clients and their advisers. Well-designed structured investments and structured products funds are included within this category, and as a result I expect their appeal will grow. For those fortunate enough to have cash savings, a substantial threat on the horizon is inflation. With rates in the cash savings market at an all-time low, I think it's likely that some savers will look to structured deposits for inflation protection, while others may look further up the risk scale to structured products funds and low-risk equity portfolios.

Q As a structured products provider, what areas of support for advisers have you been focusing on?

A Our current focus is on helping advisers access our products. We offer an array of award-winning products at Investec, including funds, managed portfolios and discretionary fund management services, and it's important that we make these products just as accessible to advisers as our structured products are. Another key area of focus this year has been our adviser support. COVID-19 presented significant operational challenges to the adviser market, so we worked hard to make sure that we were as flexible, accommodating and accessible as possible for advisers. Our digital platform, Investec For Advisers, proved invaluable for advisers during lockdown, and developing our digital infrastructure is a key area of focus for us over the next 12 months.

Q What do you feel are the main benefits of structured products that advisers should be pointing out to clients?

A One of the principal benefits of structured products (whether held individually or collectively within a fund) is the flexibility of their return profile, whereby they can be designed to generate returns in flat or falling markets. The peace of mind that comes from knowing you'll get back your capital as well as a positive return, even if the market falls by 20%, is invaluable to an investor in the current environment and is what sets structured products apart from other types of equity investment.

Q Structured product performance has been extremely impressive over the last decade. Do you think this needs to be better communicated to advisers and investors?

A Over the 10-year bull market of 2010-2020, most types of equity investment generated impressive returns. Structured investments performed very well, but equity funds delivered the highest returns – either way, that period is behind us and to some extent is irrelevant. The COVID-19 crisis of 2020 has been a stark reminder of the risks of equity investing – both in terms of capital preservation as well as foregone returns. The important questions right now are how to protect capital from market risk and inflation, as well as how to generate returns in a variety of market conditions – not just when markets are rising. I think that properly designed structured products and structured products funds certainly have a role to play here, and communicating this to advisers and investors is important.

Exciting times

The structured products market has never been in better shape, and the current range of products should be compelling for investors seeking the magical combination of capital protection and the ability to generate decent returns. The hope is that further evidence of their merits could soon be forthcoming.

"There is a lot of excitement around just how well the sector has both evolved and performed," says Ian Lowes. "We know that past performance is not a guide to the future but when we look to the future, there's palpable excitement about how well the sector will perform relative to other passives, given the COVID-19 crash. The FTSE is still a long way from potentially breaching any protection barriers and while some autocalls that had maximum six-year terms still have a few years to allow the FTSE to recover, the longer-term plans typically have until 2025 and beyond. If the Index does recover by then, these will be maturing with significant gains."

To learn more about structured products, check out Tempo's video webinar for advisers, 'SPs: Need; Evidence; & USPs', on 9 December 2020, 2.00 – 3.15 p.m. For further details of this CPD-accredited presentation and to register, please visit: tempo-sp.com/newsroom/events