Structured investment products as income financial instruments for banks – profit centers analysis

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Abstract: The global financial crisis which started in 2008 has brought the decline in the confidence for investments on the capital market. The fear and aversion to investments on the capital market were particularly observed among individual investors, whose the value of assets, as a result of the crisis, decreased even by 50 percent both from direct investments and through investment funds. Since investment risk has increased dramatically, and the profitability of conventional bank deposits fluctuates around the level of inflation, there are seen the increased interest in a new form of investing of available funds. These are structured investment products. For several years their market constantly evolves, and this development is noticeable in various studies and financial analysis. However, during the literature studies, there might have the impression that banks, offering such products, mainly are aimed at satisfying customers’ investment needs, regardless of own economic conditions of their own offer. But it is not. As financial institutions profit-oriented, they also derive considerable profits from these instruments, what is rarely mentioned in financial studies. According to the above, it is reasonable to discuss structured investment products from the point of view of the banks as their suppliers, as well as an analysis of economic and financial conditions contributing to their generated financial profits. These considerations are the main aim of the study, which will be achieved through the study of selected, available literature as well as using own author’s knowledge.

Keywords: structured investment product, bank, above-average profit, guaranteed capital, investment risk

JEL classification: G24

Biographical notes: Janusz Cichy PhD is an academic researcher and teacher for 20 years. An adjunct in the Department of Banking and Financial Markets at the University of Economics in Katowice, in Poland. He lectures in the field of commercial banking and capital markets. His interest focuses mainly on three areas. The first is the issues of banking services for companies, particularly corporate and investment banking services. The second area is rating and credit rating agencies activities. The third area is the financial management of banks and fulfilling regulatory or supervisors requirements by them. He is also a promoter of many diploma works and master thesis. He cooperates as an expert with banks and a web portal. He is married, has one child – a son. Privately, he is interested in film, travelling and biography literature.
1 Introduction

A few years ago, banks offered structured investment products mostly to wealthy clients, adjusting their characteristics to preferences and financial resources of individual customers. However, as a result of the global financial crisis and the collapse of the investment fund market, wealthy clients, as well as those less well-off, have started to look for new, safe investment products. Moreover, banks - over time - have begun to reduce the minimum financial requirements of subscription. High investment risk on the capital market and low interest rates of bank deposits contributed to popularize the structured products which have become top investments in the last decade.

Almost every commercial bank, for its strategic goal, chooses an opportunity to offer these products, based on the selected underlying instrument, to customers. Increased banks’ activity in this area practically meets the investment needs of potential clients who expect a higher profitability without incurring excessive risk. On the other hand, what can not be forgotten, structured products for bank are a source of income, without incurring credit risk, as it is in the transformation process of the bank deposits into credit instruments.

2 Structured products – definitional aspects

Structured investment products, which are the subject of this study, rarely (in Poland at all) are discussed from the point of view of profits for the potential issuer. All Polish and foreign publications, whether books or articles, mainly consider this financial instrument when it comes to needs, risk and benefits for the investor.

Structured products, targeted to individual clients, are the most innovative and flexible investment instruments. There is no one valid definition of a structured product. Individual definitions often identify the characteristics or features of the instrument. Most structured products are defined as investment tools created by the combination of various financial instruments offered to investors in order to achieve higher profitability than from direct investments in the underlying instrument. According to S. Das (2001) structured products are a combination of fixed income instruments and derivatives, which usually have the profile of forward contracts or options issued to various underlying assets. Another definition can be found in the training materials of Warsaw Stock Exchange, which define structured products as financial instruments issued by banks or investment companies with price determined by the value of a particular market index, such as share price, foreign exchange rate and the stock market index.

Structured investment products have become popular in the United States in the 80s twentieth century, while they reached Europe a decade later. Since then, a number of products implemented to the market has systematically increased. Moreover, the value of sales has also grown. At that time, the growing popularity of structured products resulted from the current situation on the financial markets [Kubacki 2012, p. 209]:

- low interest rates in 1997-1998, which resulted in the loss of significance of traditional investment instruments in favor of innovative forms of investment,
- the collapse of the capital market in 2000-2003, caused the increase of using in a large scale of other underlying instruments based on the real estate or raw materials.

Volatility of capital market caused seeking safer investment instruments by investors, in order to limit potential losses. The issuers quickly reacted by the investors’ needs, by offering newer and more innovative products. The development of structured products market slowed during the global financial crisis 2008-2009. They were criticized,
especially those based on debt. However, it can ask whether the fault is the result of the
equity or participants - investors and issuers.
While the financial crisis slowed the global market of these products, however after this
period, for example in Poland, the popularity of structured products has grown rapidly.
This tendency due to the fact that interest in them is negatively correlated with the
condition of the stock market. During the bull market, structured products are treated as
investment instruments mainly for investors who do not accept excessive investment risk
and for active investors - as a tool to diversify investment portfolio. The volatility of the
stock market or even a bear market are periods which conducive to the popularization and
the increase in sales of structured products. They guarantee the paid-in capital and
provide the opportunity to achieve higher rate of return rather than from conventional
bank deposits, but also from direct stock exchange investments. Another reason of the
growing market of these products in Poland was the lack of mutual confidence between
financial institutions, especially banks in 2008-2009. On the one hand, clients because of
the drastic depreciation of assets, withdrew from the stock market, and on the other hand,
they withdrew funds held in banks, fearing their solvency problems, especially those
which were a part of the international banking groups. To reduce the outflow of funds,
banks have increased the interest rate, but this trend could not last forever due to the
increasing costs associated with the loan. The offer of structured products, which for
most individuals investors were financial innovations then, allowed to keep some
customers and gain new ones. Of course, obtained capital in this way were not allocated
to the banks’ core activity such as lending, however, they allowed to generate income
without incurring credit risk.
Structured products can be freely created, depending on the investor’s needs, his financial
capabilities, time period, the investment objective and willingness to take risks [J. C.
Francis. W. Toy 2000, p. 26]. Similar features of structured instruments as financial
products, created for the specific needs of investors, indicates A. Bluemke (2009), who
consider them as instruments meeting the specific investment requirements of the
individual client and at the same time minimizing the risk of the portfolio.
It is generally accepted that in order to define financial service as a structured product, it
has to meet the following four requirements:
- the value of capital over the period of the investment must be fully or
  partially protected,
- investment duration has to be agreed in advance,
- the rate of return must be based on a predetermined formula,
- derivative product has to be built-in into the construction of a structured
  product.
Structured products have multi-sectoral character. This is due to their diversity, and their
dealer does not have to be a financial institution from the respective sector. Banks are the
best example because in their offer they have both classic structured deposits as well as
insurance products. Their multi-sectoral nature makes it difficult to implement uniform
regulatory standards, nevertheless some countries have introduced standards for
construction and offering structured products. This group of countries includes: United
Kingdom, Italy and the United States.
In the United Kingdom, regulations of Financial Services Authority (FSA) refer to the
construction process of structured products and how to present them to clients. According
to them, the financial institution is obliged, in particular for:
- clear and precise identifying of risk of the product, its assessment and
  verification of appropriate identification,
- carrying out the procedure of due diligence in the selection of financial
  instrument’s issuer,
analysis of the proportion of allocation of investment income between the participants and the assessment of correctness of this allocation, especially from the point of view of the investor’s interest,

- selection of appropriate types of products for potential client, taking into account its preferences and the level of acceptable risk,

- analysis of the product characteristics in order to meet all the adequate regulations.

The advertising message, which presents structured products, has to:

- identify where the capital is invested,

- explain the nature and level of potential risk, which invested capital is exposed,

- avoid ensuring clients that invested funds are ‘protected’ or ‘guaranteed’.

In Italy supervisory regulations Commissione Nazionale per le Società e la Borsa - (CONSOB) consider issues related to the transparency of structured products and client’s awareness about the taken risk. The financial institution is required to get to know investor’s preferences before it offers him the selected product. It is important that customers identify investment time horizon appropriate for their liquidity preferences, the expected benefits and the level of risk which they are willing to accept.

Financial Industry Regulatory Authority – FINRA, which operates in the United States, focuses on dissemination of knowledge among investors about the functioning of financial markets. Issue and distribution of structured products in the American market is a public offering, so there are specific information requirements. FINRA recommends that potential investors are aware of market risk by analyzing the prospectus, objective of the investment, volatility of underlying instrument and the amount of the incurred costs. They should also have the knowledge of principles related to investment. The awareness that higher profits mean potentially higher risk, limited trust in advertising of structured products, especially when it comes to rate of return, a full understanding of the product and its mechanisms, and the use of portfolio diversification is a necessary prerequisite of investing in such instruments.

The European Commission has also made an attempt to develop uniform standards for the protection of investors who buy financial products for investment purposes. These standards are applicable to all European Union countries member, and their goal is to allow clients comparison of products in easier way, including structured products that can be offered in the form of deposits, insurance products and securities.

The above examples of attempts of regulating the processes of constructing and offering structured products are aimed at significantly reducing the information asymmetry which exists between issuer and investor. These regulations are intended to ensure transactions’ security and provide investor’s optimal knowledge about the investment and incurred risk.

3 The construction of structured products and their classification

The potential opportunity for investors to gain over-normative income, results from the method of construction of structured product. Cash resources invested by the customer are divided into three parts: ‘safe’, market and a margin. Many of obtained funds by the issuer are intended to the achievement of the guaranteed amount of the payment to the investor, so that they must be invested in safe financial instruments. They are usually zero-coupon bonds, mainly issued by the State Treasury, with the intervals adapted to the maturity of the product. The resulting discount, which is the difference between the purchase price and a nominal value, is used to finance the purchase of a derivative, which
is an option. Its acquisition is a part of the ‘market’ investment, which is used by the issuer to secure its position after the subscription, in order to be able to pay the investor a specified profit according to the agreed formula at the maturity. Of course, the amount of the distributed profit depends on the price of the underlying asset and the market trend. The customer is entitled to unlimited profit, but it is not exposed to unlimited loss, because the rate of return of a structured product may be higher, in the worst case – may be equal to the guaranteed rate (excluding inflation and assuming 100 percent of guarantee of the contributed capital). The amount of money paid by the customer, which is not invested in bonds or options, is an issuer margin. Its value is not determined by price development of underlying instrument or investor’s profit and is collected at the end of subscription.

Issuers of structured instruments demonstrate a high degree of flexibility in creating their constructions, by adapting them to the needs, financial capabilities and levels of clients’ acceptable risk. These instruments might be issued for different maturities, making it possible to obtain a certain benefit when the underlying instrument gains in value, or when it loses.

The diversity of definitions suggests a multiplicity of structured products, and this prevents the creation of a universal pattern. Such products do not form a homogeneous category, which impedes their classification, although both in reports about the capital market (Stock Exchange Yearbook 2012, pp. 91-92), as well as in the financial literature (Olszewski 2008, pp. 55-90) can be found an attempt of their systematizing (table 1). All of the above criteria allow investor to assess what the structured product is and what characteristics it has. However, investments in such instruments are mainly undertaken by individual investors who do not have discernment in the intricacies of the financial markets. The main question that can be asked is whether all investors have the knowledge about the underlying instruments or their basket, methods of calculating rates of return and the participation rate? Of course not. Therefore, it can be argued that in addition to knowledge of the possibility of obtaining a higher rate of return than from the classical instruments, the potential investor pays particular attention to the protection of the invested capital and the time horizon of investment. This is due to the level of risk which it is willing to accept. Products ensuring capital protection are very safe because an investor does not face the risk of nominal loss. However, their structure indicates that the guarantee of the capital is only at the end of investment, therefore, during duration of the deposit, there is a high liquidity risk. In turn, the products, which do not guarantee capital protection, are risky due to the requirement of the investor’s participation not only in profits, but also in losses generated by the underlying instrument.

The second very important criterion is the maturity, which is associated with a particular legal form and the specificity of the structured product, as well as the nature of the client and its willingness to give up liquidity for a specified term. Due to the time of preparation, short- and medium-term instruments predominate in the form of investment bank deposits with the maturity of up to three years.

*Growth* type products do not give the holder the opportunity to participate in the current profits, and their goal is to get the highest product’s value within its maturity. However, *income* type products offer investors regular income payments, which the value is dependent on the changes of the underlying asset during the specific investment period. The overview of structured products is generally made according to the criterion of form of product. And according to this criterion, there are investment bank deposits, structured bonds, structured certificates, insurance policies and investment funds. Each of these forms are characterized by a different degree of operational feasibility, legal risk, availability for investor and liquidity.

Structured deposit is the most popular form of such product. Bank is the issuer and also conducts a process of distribution. The formula of payment to the client is guaranteed by
a bank in the deposit agreement, wherein usually applies 100% of capital protection level. Cash resources placed on the deposit are covered by the warranty of national deposit guarantee scheme.

Structured bond is a financial instrument ensuring capital protection, and the income is paid in the form of a variable rate coupon. However, it should be noted that investor purchasing the bond becomes a creditor of the issuer and assumes the related credit risk. This risk applies to income as well as invested capital. Investors acquiring structured certificates are also exposed to credit risk. Structured certificates are securities, issued by financial institutions, usually banks or brokerage houses. Buyers of structured bonds or certificates are exposed to the risk of partial or total lack of payment of interest by the issuer or the amount of the purchase. The lower issuer’s creditworthiness, the greater risk of loss.

Both structured bonds and certificates, in the opposite to bank deposits or insurance policies, can be traded on the stock exchange, which improves their liquidity. This is an advantage from the point of view of an investor who, at any time prior to maturity, may sell or purchase this financial instrument. However, it should keep in mind that guarantee capital, specified in terms of the issue is only valid at the time of repurchase, and the earlier sale on the stock exchange may result in a loss. Exchange trading of these instruments also allows on their real-time valuation.

Life insurance or annuity policies are issued by insurance companies, and a bank is usually their distributor. The cooperation between an insurance company and a bank may have often tightly character. The agreement may take the form of individual insurance (where insurance company and client are parties), or group insurance - in this case, the customer enters into a contract concluded between a distributor (which is in this case the policyholder) and an issuer (the insurance company). A characteristic feature of structured products in this form is that there is a protective element resulting from covering client of life insurance.

The last of the major forms of structured products is a closed-end investment fund. The fund is an issuer of a structured product, and its distribution to the primary market consists in accepting subscriptions from participants. Such subscriptions may be conducted by a domestic bank, a branch of the credit institution and brokerage house - institutions that have the legal rights to run a business in the field of the accepting and transferring buy or sell orders of financial instruments. Investors receive investment certificates that can be publicly traded on the stock exchange.

The main part of the construction of mentioned forms of structured products is similar, however they may vary among themselves in:

- the amount of the guarantee of invested capital - whether the capital is guaranteed up to 100%. or at a reduced level,
- the subject of the guarantee - whether covered by the guarantee is only invested capital. or also the interest,
- the duration of the deposit - usually 3-5 years,
- the amount of the required minimum investment amount – in order to promote structured products among potential investors’ ‘entry thresholds’ are constantly being reduced,
- using a variety of underlying instruments or basket of these instruments,
- the formula of calculating achieved rates of return - depending on the chosen option,
- investor’s participation rate in rate of return on the underlying investment achieved by the issuer – which the value is determined by the amount of raised funds in the subscription, investment period, the amount of the
guarantee of capital and/or interest, pricing conditions of option purchase and investment policy.

This diversity of construction of structured products causes practically their inability to make a direct comparison, even based on the same underlying instruments. There can also be done a comparative analysis of collected commissions and fees by the issuer and distributor, which is so important, because they are not disclosed to investors. [A. Georgieva 2005, p. 37].

Structured products have many advantages, and the most important ones is obviously protecting capital. But this is not the only advantage. They allow investors to participate in the broadly understood global financial and commodity markets, and indirectly acquire financial instruments and other assets, to which access is limited and involves significant transaction costs. This type of investments contributes to the risk diversification due to the nature of the underlying instrument and in geographical terms. They are also used to reduce or avoid losses, when stock exchange situation deteriorates the domestic financial market. A number of structured products are listed on the stock exchange, and this fact allows to withdraw from the investment before the maturity, safety and trading transparency, full information about the product and the issuer as well as their current valuation.

However, structured products, despite a number of advantages, are not free from defects. The most important ones are:

- lack of possibility of early termination of the contract by the customer, without incurring high fees (excluding products which are listed on the stock market, although they can not be given to the issuer to early redemption, but they can be liquidated on the stock market),
- complicated form of calculation of profit for investor,
- lack of detailed law regulations about the construction and trading and information about the incurred fees,
- risk of issuer’s bankruptcy – however there is always small risk, especially having regard financial problems of financial institutions during the crisis in 2008-2009,
- in the maturity date, option may be out of the money - then the investor receives only the guaranteed capital,
- inflation, which reduces the real value of the guaranteed capital.

The possibility of obtaining potential much higher profits than achieved from conventional financial instruments is the primary determinant of the investors’ interest of structured products. However, as indicates the Report published in 2010 by Polish Financial Supervision Authority, almost 50 percent of all structured products available in 2000-2010 did not bring any profits or their annual rate of return was below 1 percent. In turn, only 40 percent of all available structured products in this period have provided higher annual rate of return than the classical bank deposit. Based only on above data from the Polish Authority, potential rate of return on structured product is not the same as achieved after several years of investor’s investment. Investor may obtain above average profits, but it can also receive only guaranteed capital after years of investment, which means a loss due to inflation, which is an inherent feature of any economy. Therefore, it should be changed the point of thinking about structured products and take into account their profitability also from the perspective of the issuer - mainly commercial bank. Although banks do not publish the value of generated revenues from the issuance of such instruments, however it is worth to try to analyze income-generating areas of the issued and offered structured products to clients.
Structured products as a source of bank’s income

An inherent feature of any banking system in free market economy countries is its competitiveness. In order to meet it, banks have to constantly fulfill the growing clients’ financial needs by expanding their offer of services and financial products. This allows to generate projected revenues and profits, which are the core of funding further development of a bank. Bank is a profit-oriented institution, so it is almost impossible to find a banking product that is not intended to bring its certain level of income. Also offering structured products is aimed not only to provide a potentially higher rate of return on investment for investor, but also (and perhaps above all) for bank. Each investment structured product is issued at a predetermined time, starting with its launch, preceded by gathering funds from potential investors, and ending with the redemption by the issuer or disposal it on the secondary market. Throughout this period, bank can generate the specified income.

Most structured products are sold by subscription. Deadline for client’s payment of cash resources is not the same as the launch date of the product by a bank. During this period, investor’s funds are blocked and mostly interest-free. Therefore cash resources during the subscription period are available for bank, which can allocate them on short-term investments in the money market by buying treasury or bank bills, or investing them on overnight deposits. For example, on Polish financial market the minimum yield of short-term securities in the open market operations, sets by Polish National Bank as at September 12, 2013 was at the level of 2.5 percent per year. In turn ‘POLONIA’ weighted average rate of operations on the money market with a maturity of overnight (equivalent of EONIA rate applicable in the euro area) was on that day at the level of 2.43 percent.

Structured products, which are not traded on a stock exchange, in particular structured deposits, are characterized by a strongly limited liquidity of funds contributed by an investor. In order this limited liquidity does not become a barrier to investment decisions of clients, banks in their offer have quickly providing loans, often on preferential terms, collateralized by the form of an open deposit. For customer, it is potentially profitable to take this loan, assuming that the loan cost will be lower than expected rate of return on the investment, while bank increases the volume of bank loans and receives an income in the form of interest payments, with relatively low or even zero credit risk. Lack of bank's credit risk due to the fact that even when a customer will get back only guaranteed capital at investments maturity, the loan within this period will be - largely or completely - repaid. However, assuming hypothetically that the loan will be repaid by the customer once, together with interest as at deposit maturity, there is a provision that the transfer of funds from the deposit to investor will take place only after its repayment of the loan with interest.

Margin remains the most important profit center from the issuance and distribution of structured products. This is a part of the amount paid by an investor, which is not intended to nor safe investment which guarantees capital, nor market part in certain option instruments. The amount of a margin, charged by a bank, is determined by:

- a guaranteed rate of return - it can be set to 0, when the capital is guaranteed at the level of 100 percent, or above or below zero, respectively ensuring capital above or below 100 percent,
- annual interest rate adopted for discounting - dependent on the profitability of the securities representing the secure portfolio investments,
- length of the investment period,
- option price,
- participation rate.
Exemplary embodiments of margin of three-year structured product are shown in Table 2. Numerical examples, presented in table 2, illustrate the mechanism whereby issuers of structured products may also change the parameters of prepared instruments - the level of the guaranteed rate or participation rate - to get margins at a level of advance assumed value. Setting the level of margin it should also be taken into account risk fees and distribution fees. Risk fee - in structured products - is in the form of insurance products. It reduces the margin received by the issuer and distributor and allows payments in case of insured death. Due to the extensive network of banks branches, they often play not only the role of issuer, but also distributor of structured products. Especially insurance products. According to research conducted in Poland in 2000-2010, risk fee amounted to an average of 0.17 PLN for each 1 000 PLN, paid by a client (approximately about 0.20 USD per each 1 000 USD). While the amount of distribution fees ranged from 1 to 5 percent. In turn, the average margin of structured products amounted to 2.17 percent, with a minimum level of 0.42 percent and the maximum of 5.69 percent. The profitability of the bank due to obtained margins can be compared with the average margin of bank deposits by maturity. A margin deposit it is a difference between the base cost of obtaining funds by a bank on the financial market (WIBID rate in Poland as the equivalent of LIBID rate) and the average interest rate of bank deposits with appropriate maturities. In last few years, the margin on deposits up to 1M amounted to more than 0 percent but less than 1 percent. While the margin of deposits between 1M and 1Y was a negative value. It means that the average cost of raising capital from depositors was higher than the potential costs of raising funds on the financial market. What is significant in the case of analysis of deposit margins. Deposits, obtained from customers, are the primary source of financing of bank’s activity, on which it bases its profitability. Negative value of margins means financing of statutory activities of a bank through relatively expensive cost, using deposits with longer maturities. And this entails higher bank lending rates and the potential increase in credit risk. Margins of structured products are a kind of bank’s profit almost without any financial risk. Another fee, rarely taken by the issuer, is a handling fee for the acquisition of the investment by an investor. It significantly reduces the client's potential profit, especially in short-term investments. Banks often reduce the amount of this fee when a customer pays a predetermined amount or makes a payment in the first days of the subscription. In each structured product is also a fee for withdrawing funds before maturity, because capital guarantee works only maintaining the investment by the end of the assumed date. There is no developed standards to allow compilation and comparison of such costs. In the case of structured deposits, banks can easily determine how much of the invested amount will be paid to the investors if they do not wait to the end of the deposit, and handling fee decreases every day of duration of deposit. In the case of other forms of structured products, it is difficult to determine in advance what part of capital will not be returned to the client. This depends on the valuation of the option contract. Moreover, bank often charges liquidation fee. Commonly in the customers’ opinion, it is considered that banks do not inform sufficiently reliable and completely about offered product, and in particular about any potential charges in the case of early withdrawal. Therefore, supervisors often are interested in this problem. For example, the supervisory authority in Poland (Polish Financial Supervisory Authority) after numerous complaints, has forced the banks to a higher level of substantive knowledge of the people who directly sell structured products. It is also important to banks pay special attention to the individual needs of customers and adapt available products to these needs. Finally, agreements, regulations and financial terms should be constructed so as to be clear and understandable to clients. The
supervisor also draws attention to the importance of fair activities, pointing out that companies which offer structured products are institutions of public trust and, they should not impact on the decrease of social confidence to whole banking system.

Above overview of the profit sources generated by banks from structured products indicates two "faces" of those financial instruments. For investor they are instruments with higher potential profit. But it should be remembered that it is exposed to a number of costs in case of default of the contractual terms, and capital guarantee loses its value due to a decline in the value of money over time. In contrast to investors, structured products are generally profitable for banks, with lack of risk associated with the classical bank deposit. The possible negative consequences of market risk are always incurred by client, who in this situation achieves a lower rate of return.

Although, banks do not bear the risk associated with the classical bank deposit, as issuers of structured products they are not risk-free of:

- market risk - in the case of decreasing interest rates and increasing option prices during the subscription period. This risk is limited due to the practice of setting financial parameters after the end of subscription.
- credit risk – related to the creditworthiness of the option issuer and even the risk of its bankruptcy.
- liquidity risk - if an investor has the opportunity to withdraw funds before the maturity without additional costs.
- business risk - in the case of a lower subscription value than bank has expected.
- reputation risk - when another structured product does not generate expected revenue for an investor.

Structured products are an opportunity of above-average profits for investors, but also for banks because of the benefits that they may bring. Although banks, offering them, are exposed to the above-mentioned risks, they do not threaten their financial stability, and financial products of this type are and will be a permanent source of income on increasingly developed market.

5 Conclusions

Structured investment products became a permanent part of investment offer of banks. Admittedly investing in them does not require specialized knowledge about financial markets and instruments, however constant education of potential customers should be a priority in this area. Moreover, an investors should be aware of the need of getting to know terms of their issue, and expected market conditions. On the other hand, banks should leave incomprehensible investment strategies in favour of simple and clear for every investor, based on the well-known factors of each investor.

Above postulates will contribute to the development of the structured products market the more so because they are an appropriate form of funds allocation for people who are less active in the field of financial operations, do not accept the risk, but seek to higher income than from a simple bank deposit. These people are faster able to accept lack of profit than the losses. Widening a group of potential investors is also a chance for a bank, for which wider offer is an opportunity to increase profits.

In conclusion, increasingly wider range of structured products is in the interest not only of customers, who may receive alternative investment opportunities, but also banks, which see new profit centers into them. Potential investors should be aware of that banks are not charitable institutions and there are no financial products with extraordinary profits without investment risk.
### Table 1: Classification of structured products

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Name of the structured product</th>
</tr>
</thead>
</table>
| Construction of instrument    | - *Principal Protected Notes* – products which ensure full capital protection  
|                                | - *Yield Enhanced Notes* – products which do not ensure full capital protection                                                                                                                                            |
| Maturity                       | - Short-term products  
|                                | - Medium-term product  
|                                | - Long-term product                                                                                           |
| Structure of the coupon        | - *Growth* type products                                                                                       
|                                | - *Income* type products                                                                                       |
| Type of the underlying instrument | - *Equity-Linked Notes* – products, which profit is determined by the price development of shares on the market  
|                                | - *FX-Linked Notes* – products, which profit is determined by the changes of Exchange rates  
|                                | - *Interest Rate-Linked Notes* – products, connected to the level of interest rates  
|                                | - *Hedge Fund-Linked Notes* – products, which rate of return is determined by the value of hedge funds units  
|                                | - *Commodity-Linked Notes* – products, based on the commodity markets, such as: oil, natural gas, cooper, gold  
|                                | - Products based on the real estate market  
|                                | - Hybrid products, based on the various classes of assets – the value of profit is determined by the several markets, which differ from one another  |
| The nature of the investment   | - Investment products – with the longer, several years maturity, such as structured bonds  
|                                | - Speculative products – based on the underlying instrument with the short-term time horizon, from few months to about one and a half year, such as structured certificates.  |
| Form of a product              | - Investment bank deposits (indexed)  
|                                | - Structured certificates  
|                                | - Structured bonds  
|                                | - Life insurance or annuity policies  
|                                | - Investment funds                                                                                           |


### Table 2: Examples of margin

<table>
<thead>
<tr>
<th>Margin (%)</th>
<th>Guaranteed rate (%)</th>
<th>Discount rate per annum (%)</th>
<th>Option price (%)</th>
<th>Participation rate (%)</th>
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<tr>
<td>4.21</td>
<td>10</td>
<td>4</td>
<td>10</td>
<td>60</td>
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<tr>
<td>5.10</td>
<td>(1.67 annual)</td>
<td>0</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>4.10</td>
<td>(1.35 annual)</td>
<td>0</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>8.55</td>
<td>(2.77 annual)</td>
<td>(guaranteed capital at the level of 95 percent)</td>
<td>4</td>
<td>10</td>
</tr>
</tbody>
</table>

References