

MAKING SENSE OF STRUCTURED DEPOSITS

There are a variety of structured deposits being offered in the market today. They have many characteristics that are similar to investments and may be complex. The purpose of this guide is to help you understand what structured deposits are and what you should look out for before investing in such products.

We start with a case story of how one person had bought a structured deposit without fully understanding how it worked.

CASE STORY

Mr Daniel Goh put \$50,000 of his savings into a 5-year equity-linked structured deposit, offering principal protection and a higher return compared to a fixed deposit. The exact size of the return would depend on the performance of a basket of stocks. Two weeks after buying the product, Mr Goh needed money urgently and approached the bank to withdraw his structured deposit. The bank informed him that this would be regarded as an early withdrawal. The bank explained that it would have to unwind the positions it had taken in the underlying stocks at their prevailing market value. This would result in a loss of \$7,000 on his original investment of \$50,000.

WHAT IS A STRUCTURED DEPOSIT?

A structured deposit is essentially a combination of a deposit and an investment product, where the return is dependent on the performance of some underlying financial instrument. Typical financial instruments linked to such deposits include market indices, equities, interest rates, fixed-income instruments, foreign exchange or a combination of these.

HOW DO STRUCTURED DEPOSITS COMPARE WITH FIXED DEPOSITS?

Structured deposits have some important characteristics that distinguish them from traditional deposits. In the case of fixed deposits, the returns and maturity periods are fixed. Structured deposits on the other hand have variable returns, and in some cases, variable maturities as well.

Variable returns - Structured deposits generally provide the possibility of higher returns compared to fixed deposits. However, you should balance this possibility of higher returns against the risk of variable returns. In some scenarios, you may get lower or no returns at all.

Variable maturities - Structured deposits have maturity periods that vary from as short as 2 weeks to as long as 10 years. This means that you may not be able to use your money for other purposes before maturity. Some structured deposits include an agreement that enables the bank to redeem or “call” the deposit before the maturity date for reasons specified in the terms and conditions of your contract. Where a structured deposit is callable, you can expect to receive, at a minimum, the full value of your principal. Depending on the circumstances, this early redemption feature may benefit you. For example, if you wish to use your money in other ways, you can get back your principal (and possibly, additional returns) as soon as redemption occurs. You may, however, be exposed to reinvestment risk. This is the risk of having to invest your money in a low interest rate environment when interest rates fall.

Depending on market conditions and your specific investment needs, a structured deposit may or may not be a good investment to put your money in. You should ask your financial adviser to explain the risks and returns of the product under various market conditions.

WHAT HAPPENS IF I NEED TO WITHDRAW MY DEPOSIT BEFORE THE MATURITY DATE?

Structured deposits, like fixed deposits, are meant to be held to maturity. Your principal will be repaid in full only at maturity. If you withdraw your deposit before the maturity date, you may lose part of your return and/or principal. The amount payable to you depends on the market value of the underlying financial instrument that your structured deposit is linked to, which cannot be pre-determined.

You should also bear in mind that structured deposits may be subject to periodic valuation, which may not be on a daily basis. This means that you may not be able to withdraw your deposit immediately. Check the terms and conditions for early withdrawal of the deposit with your bank.

WHAT SHOULD I CONSIDER BEFORE INVESTING IN A STRUCTURED DEPOSIT?

Structured deposits come in different forms. You should consider whether a structured deposit fits with your financial goals, risk appetite and personal situation. When choosing a structured deposit, consider the following:

- Liquidity.** Consider your liquidity needs as your money will be tied up for a period of time and early withdrawal may result in loss of part of your return and/or principal. Make sure that you have sufficient savings set aside before investing in structured deposits.
- Risks.** Determine whether you have the risk appetite for these products. Structured deposits are riskier than normal fixed deposits. You should understand the risks involved and what will happen in a worst-case scenario. If you are unsure, seek financial advice from a professional.
- Returns.** As structured deposits are tied to underlying financial instruments such as market indices, equities, interest rates, fixed-income instruments, foreign exchange, or a combination of these, you should understand how the performance of these instruments affect the return on your deposit. Remember that past performance is not necessarily indicative of future performance.

- ☑ **Terms and Conditions.** Read the terms and conditions and other documentation of the structured deposit carefully before making any commitment. If you do not understand how the product works, seek clarification. Do not buy anything you do not understand.

WHAT INFORMATION SHOULD A FINANCIAL ADVISER DISCLOSE TO ME WHEN RECOMMENDING A STRUCTURED DEPOSIT?

Structured deposits will be regulated under the Financial Advisers Act (FAA) from 1 June 2005. From this date, persons advising on such products are subject to the standards of conduct set out in the FAA Guidelines on Structured Deposits. Under the FAA, only qualified financial adviser representatives are allowed to market or provide financial advisory services on structured deposits.

When the new rules come into effect, your financial adviser must provide you with a fair and adequate description of all material information on the structured deposit including:

- Nature of the product and how it works, including the underlying financial instruments used.
- Details of the product provider.
- Benefits that are likely to be derived from the product, the amount and timing of benefits and whether the benefits are guaranteed or non-guaranteed. Examples of how structured deposits work, including a worst-case scenario, should be provided. Be wary of headline rates or examples showing benefits that are unrealistic and unlikely to be achieved.
- Risk factors that may affect your returns or put your principal at risk.
- All fees or other charges.
- Early termination clauses including the fact that the principal is only guaranteed if the product is held to maturity.
- Any warnings, exclusions or disclaimers in relation to the product.

For more information on the FAA and the FAA Guidelines on Structured Deposits, visit the MAS website at www.mas.gov.sg. You can also refer to the guide, “Dealing With A Financial Adviser: What To Look Out For?” at www.mas.gov.sg/consumer.

More information on structured deposits and how they compare with Singapore dollar fixed deposits can be found in the full version of this guide available at www.mas.gov.sg/consumer.