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■ **STRAIGHT TALK** / B Gopkumar, senior VP & all India head of financial planning group, Kotak Securities Ltd

'A structured product is a product in which you know the end result before you buy it'

B Gopkumar, senior vice president & all India head of financial planning group, Kotak Securities Ltd speaks with **Abhay Rao** *of The Financial Express about structured products being offered to the retail investor and how should they go about these investments.*

What in your opinion is a structured product?

A structured product is a product in which you know the end result before you buy it. This is the structured part of the product, and it is this endearing quality of these financial instruments that have led to increased investments in them post January 2008. Globally, structured products are one of the largest selling products in the world of wealth management.

However, one must note this is a product and not an asset class. Structured products are built in such a way that they try to mould themselves to an investors risk appetite, while covering a large area of investment options. They usually have a 3-year lock-in period and are capital protecting in nature.

What are the different types of structured products available in the market and what is the basis on which these products function?

There are various types of structured products in the market. Every product that is structured differently to suit an investor becomes a structured product and as such it is very hard to categorise them all. Though some examples of the different products available are Nifty-based, basket of stocks, single stocks structure, etc.

In a basket of stocks structured product say you have five top stocks, the banker or portfolio manager who has designed this product and is selling it will put certain conditions in this product, which, if they occur, provide investors with a handsome return. So say the basket of stocks product may have a clause that states that if this basket of stocks moves 6% up in 3 months you will get a 20% return plus your capital guarantee.

So, if one is bullish on these five stocks the product is offering, he might be very interested in going in for such a structured product. However, these products are now dropping in sales as fewer people are sure of their market sentiments in these times.

Within Nifty products available to investors, there are also various other types. These are all participation products, which do have a capital guarantee. One of the types is a reverse convertible structured product.

An example of this is, say for 3 years the Nifty remains positive, the bank or company which sold you the structured product will give you a flat 57% return on investment.

However, if it goes negative, for every 1% drop, the bank/company would give you 2% less return than what you were getting. There are also other products like vanilla participation and knocked-off structured products, which are again capital guaranteeing in nature and of similar complexity as the ones I have cited.

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How does capital guarantee work in structured products and how do companies selling such products earn from the part of the funds used to protect the initial capital?

Capital guarantee products manage to safeguard an investor's wealth using simple investing. If one invests Rs 100 in a structured product, which is options based, then the bank or company selling the company will put Rs 20 in options and Rs 80 in fixed income bonds, which will mature to be Rs 100 by the end of the product tenure of say 3 years.

This way the capital of the investor is always protected and yet he has a chance to earn a return on investment. Non-capital guaranteeing products have higher risks as they do not follow this method. However, their returns and losses, if any, are also higher.

As far as the company or bank issuing structured products are concerned, they can make money from their Rs 80 invested in fixed income bonds too.

This is done as they get zero coupon bonds, while every bond is as such issued on a premium of 2-2.5%. Hence, while issuing these bonds they make their fee.

What is essential for an investor to realise if he/she wants to invest in structured products? What are the risks to be aware of?

The most important criteria for anyone who is purchasing a structured product is that they need to have a view on the markets. If you are bullish on the markets then you will buy a product that follows that line of thought and you might go in for a reverse convertible product.

Other important factors that investors should be very particular about is, understanding the structure of the product, taking note of the rating and rating agency of the product and checking if the product is secured or unsecured.

Investors should be aware of the fact that there are 3 platforms through which they can invest. One is the portfolio management services platform, which is however highly lacking in transparency. This is so much so that each party involved in the product may not know the other. The second is the mutual fund platform, which buys structured products and we in turn can invest in those funds. And the third platform is through direct debentures of the company that they may offer to their own customers. These are debt-based structured products and are the most transparent.

What is the market size of structured products? How do companies start these products?

The market size of structured products is very hard to gauge in India and it also keeps varying, which does not make it any easier. However, from being to Rs 400-500 crore a month it has now slipped to Rs 200 crore a month. The slowdown is largely due to lack of investing traffic in general and also as many of international banks are no longer trusted.

Companies start a structured product mainly to raise money. Say your company needs Rs 100 crore and you have Rs 100 crore worth of property with the help of which you plan to raise the money. You can take a mortgage to raise Rs 50 crore and give out debentures on which you can give a return of 18-19%. Then your company has to create a security for Rs 50 crore and list it in the Nifty. This is advisable to do for tax purposes. Post all this, the NBFC or bank prepares the product and then tries to sell it.