ASIC

Australian Securities & Investments Commission

REPORT 341

Retail investor research into structured ‘capital protected’ and ‘capital guaranteed’ investments

May 2013

About this report

This report was commissioned by ASIC and produced by Susan Bell Research.

It sets out the results of research into retail investors’ understanding of capital protected and capital guaranteed investments.

susanbell research

Retail investor research into structured ‘capital protected’ and ‘capital guaranteed’ investments

Australian Securities and Investments Commission

November 2011

Revised May 2012

Susan Bell Research
Phone 02 9451 1234   Fax 02 9451 1122   Web www.sbresearch.com.au
1 Cullen St Forestville NSW 2087

Susan Bell Research is a division of Les Bell & Associates ABN 44 350 636 020

AMSRO

Contents

Executive summary ... **4**

Background ... 4

Key findings ... 5

Conclusions and implications of this research ... 8

A Project background and rationale ... **10**

Introduction ... 10

Objectives ... 12

Project scope ... 13

Research method ... 13

The sample ... 15

B Detailed findings ... **19**

What type of investor has invested in structured products? ... 19

The perceived meaning of capital protection and capital guarantee ... 22

What motivated investors to invest in structured products? ... 25

How well did investors understand the product? ... 29

Why did investors choose these products over other investments? ... 35

The decision process ... 38

The role of advice ... 40

How well did disclosure work? ... 41

Satisfaction with the investment ... 43

Summary ... 45

Appendix ... **46**

Three case studies ... 46

Some notes on the methodology ... 49

Executive summary

Background

This report summarises the results of qualitative research conducted by Susan Bell Research for the Australian Securities and Investments Commission (ASIC) into retail investors' understanding of capital protected and capital guaranteed investments.

A key priority of ASIC is to ensure that investors and financial consumers are confident and informed. This comprises three elements:

- **Education**. Investor responsibility for investment decisions remains core to Australia's financial regulatory system. It is paramount that investors understand risk, reward and diversification.
- **Gatekeepers**. ASIC will hold gatekeepers to account.
- **Consumer behaviour**. Recognising how investors and consumers make decisions.

'Capital guaranteed' or 'capital protected' products are complex structured investments that typically offer investors returns linked to the performance of shares or investment markets, with some assurances about the return of their original investment at maturity. Derivatives, such as options, are commonly embedded within the product structure.

The purpose of the research was to understand how well informed retail investors were about capital protected and capital guaranteed investments, and to document how these investors chose and evaluated this type of investment.

Susan Bell Research therefore conducted exploratory qualitative research with past, current and potential investors in capital protected and capital guaranteed investments. The sample for the study was 25 retail investors, who were interviewed using a combination of telephone and web-conferencing. These 25 investors had invested in, or were considering investing in, one or more of a broad range of capital protected or capital guaranteed structured products that had been available in the market from the mid 1990s onwards. This detailed report provides more information about the interview method and sample structure.

A number of key themes arose from the research. These themes are summarised below.

Key findings

Appeal to a cross-section of investors

Capital protected or guaranteed structured products have appealed to a broad cross–section of investors, as measured by their investment experience. For example, about half of the sample had never invested in shares directly, though they had some property and/or managed funds before they invested in capital protected and capital guaranteed structured investments. The other half had experience in and knowledge of direct share investing, though had not invested in derivatives directly.

These products have appealed to some young people and young families as entry-level investments to get them started in investing. They have also appealed to older people, including pre-retirees and retirees, as a way of diversifying their portfolio.

Appeal to both risk-averse and growth-oriented investors

Capital protected and capital guaranteed structured investments have appealed to two very different types of investor, for two very different reasons. On the one hand, growth-oriented investors have been attracted to the promise of high growth or *“turbo-charged”* investment strategies, which had the potential to achieve high returns, but which had a built-in protection or guarantee to minimise potential losses. These investors were typically aware that there were risks in seeking such high returns. A capital protected or capital guaranteed investment gave them greater peace of mind, and the confidence to enter this market.

On the other hand, some risk-averse investors have chosen to invest in these same investments because they wanted to avoid any loss at all. They chose these investments as a (perceived) safer alternative to investing directly in the share market. They saw the capital protection or guarantee as removing risk.

Growth-oriented investors thought about the future, but not the past. Risk-averse investors focused on their own past experiences of investing or those they had heard about in the media, rather than the future.

Investors perceived the products to meet a market gap

The main perceived advantage of this type of investment has been that it seemed to offer investors a solution to their problem – it met a market gap. These investors, particularly the risk-averse investors, have seen these products as a way to gain a stable investment from a trusted source, such as a major Australian bank.

These investors rejected term deposits in favour of the capital protected and capital guaranteed investments because they were dissatisfied with the term deposit rate. For them, money invested in term deposits is *“not working hard enough”.*

Risk-averse investors had also chosen to invest in these structured products to avoid investing directly in shares, which they regarded as too volatile and requiring too much work and knowledge to manage.

Some of these investors would have preferred to invest in property rather than listed investments, but did not have enough money. Others had property already and wanted to diversify.

Motivations to invest

All investors expected a capital gain from their investment, and to be protected from investment losses. Investors also chose these products because they perceived them as an easy way to invest. For some, the investment provided diversification, while for a few the benefit was tax deductibility. Several investors have used the gearing facilities offered by the product issuer as a way to increase their exposure to the market.

Most equated capital protection with capital guarantee

Most investors interviewed considered 'capital protection' to be the practical equivalent of a 'capital guarantee'. In both cases, investors thought that their entire capital would be returned and that the investment had the "*backing*" of the bank. They took 'protected' to mean 'fully protected'.

A few geared investors had misunderstood what the protection applied to. They did not understand that the money they paid for the investment (interest payments) was not protected.

Direct investment and financial advice

Many investors had invested in these products directly, without consultation or advice and without any detailed product comparison. They learnt of the products through advertising, property and general investment seminars, and from bank websites and bank marketing.

Others – particularly self-described cautious investors – had received financial advice, with the financial adviser proactively suggesting these investments because of the protection or guarantee. Some of these investors now believe that their adviser did not advise them appropriately. Some have suggested that the advisers themselves had not understood the products well.

Low awareness of the conditions on protection

With the exception of some experienced investors, few of these investors were aware of the conditions on the capital protection or guarantee which are common for these types of products. While they knew that there would be a financial penalty if they withdrew early, very few were aware of the possible extent of that penalty.

Similarly, most investors did not know that the issuer of certain structured products could "*suspend*" the investment before the maturity date, or that the product could go into 'cash-lock'. This is a situation where investments are fully allocated to cash or bonds until maturity in order to preserve the capital amount, but it means that investments cannot grow beyond that. Those who knew that this situation could occur only knew because it had happened to them.

To provide the protection, some products limit the gain that the investor will ultimately receive. Some investors did not realise this.

Low understanding of the costs

Few investors had considered the fees of the product. Where fees were considered, investors expected them to be easily covered by the investment return. Some whose investments have matured now believe that the fees erode too much of the investment return. Investors did not anticipate the impact that fees might have on their capital if the products went into cash-lock, because they did not anticipate cash-lock.

These investors did not worry about the effects of inflation on their investment, because they presumed that the effects would be small. They also did not consider the opportunity cost of having their money in a long-term investment.

Investors who borrowed to invest did not typically compare the interest rate they were paying with market rates. Depending on rates at the time and whether the investment was cash-locked, some investors found that they will pay more in interest than they will receive in gain.

When deciding to invest, investors have assumed that fees, interest charges and the effects of inflation would have an insignificant impact on the final investment return. However, some investors whose products matured during or after the global financial crisis (GFC) discovered that their return was much lower than expected, and then lowered further by fees and interest rates. Some investors have found themselves in investments in ‘cash lock’, earning no investment return but still paying interest and fees.

Mixed understanding of the risks

Investors have understood that they could lose their investment because of extreme events – such as a bank *“going belly up”,* a risk they considered unlikely.

Typically, investors took short-cuts when assessing risks. For example, they looked at relatively low or modest expected returns and deduced that the risks would therefore be low/modest.

They did not generally anticipate the consequences of committing to a long-term investment should their personal or financial circumstances change. These investors did not anticipate the impact of lifestyle changes – such as getting married, having children or being made redundant – on their financial situation and their payment obligations for the investment. If they did consider such future events, they tended to be optimistic about the bank or product issuers’ willingness to be understanding and flexible.

Low understanding of the nature of the product

Some investors’ lack of understanding of the conditions, costs and risks occurred because of the way that they have conceptualised the product. They have treated the investment as if it were a de facto term deposit (with higher interest) or another retail banking product. Just as they would for these retail products, the investors have placed their faith and trust in the bank, and did not enquire deeply about how the bank would fund the product. Indeed many of these investors had not thought about the cost of the protection at all.

While experienced investors have understood that the investment was fairly “*exotic*” and may have used instruments such as hedge funds, options and other derivatives to provide the investment gain, some inexperienced investors believed that they were investing in shares, or in managed funds that invested in shares, when this was not the case.

Low reliance on documentation

Many of these investors invested directly after reading some of the fact sheets and summarised information on issuers’ websites. Product Disclosure Statements (PDSs) are available online and for these products can be over one hundred pages long. As a result, these investors did not read the full detail about how the product worked, its conditions and its risks, which is why they were unaware of them.

The research also suggests that when these products have encountered problems – such as cash-lock caused by falling markets – investors have not always received information to notify them of this change, or information that they were able to understand.

Reliance on the brand name

Linked to the two sections above (Low understanding of the nature of the product and Low reliance on documentation), is that many investors relied on the brand name as an assurance of the product quality. Some investors did not feel the need to read disclosure documents and to gain an understanding of the product, putting their trust in the brand instead. In some cases they equated the product with other 'simple' retail banking products.

Trust in the issuer's brand also led some investors to assume that the issuer would be supportive and flexible if the product or client encountered problems. However, at least one investor in this study discovered that she could not withdraw from the product when she wanted to, due to the strict conditions and illiquid nature of the product.

Some satisfied and some dissatisfied investors

The current investors that we interviewed who had invested since the GFC expressed satisfaction with their investment. This was largely because they felt that they were shielded from the recent volatility of the share market. Their investments also appear to have grown in value.

Some of the investors in the early products which matured before the GFC also expressed satisfaction, having experienced high returns and a return of their capital.

However, others were less happy. Some current and past investors whose investments were affected by the downturn in the market have had their capital returned but their investment was less successful than they expected.

Some investors found that as markets fell, the costs of investing reduced their investment gain more than they expected, which meant that locking the money away for a long term had not really paid off.

Some investors were dissatisfied because their investment had been "suspended" (in 'cash-lock'), to their surprise. Their investment was now not increasing in value, and perhaps even decreasing because of fees. Some of these investors had borrowed to invest and still had to pay interest payments on their loan, despite limited or no likelihood of a positive return at maturity.

Some investors regretted committing to a long-term investment or a loan that they could not easily get out of, when their lifestyles or circumstances changed.

Conclusions and implications of this research

In summary, the research findings suggest that some retail investors have invested in these complex structured products much as they would invest in a simpler retail product such as a term deposit. They believed the product was far simpler than was the case, and some were not fully informed about their investment.

These investors have trusted the banks and product issuers to be true to their word, which is to return their capital *"100%"*. They have taken 'protected' to mean 'unconditionally protected' when it may really mean 'protection if these conditions are met'. Investors have been aware of only one of the conditions on capital protection (that an early withdrawal before maturity will cancel that capital

protection) but even then may have underestimated the potential financial penalties of early withdrawal.

Current disclosure practices – providing lengthy detailed disclosure online, plus a fact sheet – have not helped investors to become fully informed. Investors would benefit from easily accessible information that explains the risks and costs in plain language. Retail investors need to be made more aware that capital protection and capital guaranteed products are not all the same and do not operate as a conventional retail product.

Although investors may suffer in future if their capital turns out not to be fully protected, it is also possible that their relationship with and trust in the product issuer and their advisers will also suffer.

The complexity of the documentation as it currently stands makes it almost impossible for investors to compare products from different issuers. Some also do not know to look in the documentation for the conditions because they do not expect a capital protected product to have conditions.

Some advisers may have misled their clients about the "*safety*" of these investments.

A Project background and rationale

Introduction

The Australian Securities and Investments Commission's priorities include:

Confident and informed investors and financial consumers

A key priority of the Australian Securities and Investments Commission (ASIC) is to ensure that investors and financial consumers are confident and informed. This comprises three elements:

- **Education**. Investor responsibility for investment decisions remains core to Australia's financial regulatory system. It is paramount that investors understand risk, reward and diversification.
- **Gatekeepers**. ASIC will hold gatekeepers to account
- **Consumer behaviour**. Recognising how investors and consumers make decisions.

One of the ways to achieve fairness and transparency is to develop policies and provide educational material which help investors and consumers become confident and well informed.

With this in mind, ASIC commissioned Susan Bell Research to conduct research into retail investors' knowledge of capital protected and capital guaranteed investment products. The purpose of the research was to better understand the motivations of retail investors for using the products, and to document how they chose and evaluated this type of investment.

'Capital guaranteed' or 'capital protected' products are complex structured investments that typically offer investors exposure to the performance of shares or investment markets with some assurances about the return of their original investment at maturity. Derivatives, such as options, are commonly used to deliver returns.

Various product designs and labels are used, including:

- 'Bond plus call' option products, in which part of the investors' investment is placed in a 'zero coupon bond' or deposit, which is designed to grow to the value of the original investment, at maturity. The remainder of the investor's money is usually invested in more speculative instruments such as options or other derivatives linked to the performance of shares or other assets. The amount invested in derivatives or other assets may vary with the status (performance) of the market. These investments are usually described as having capital protection, or sometimes a capital guarantee:
  - In 'Capital protected' structured products, return of the investor's original investment is promised by the issuer. This promise is generally unsecured and subject to the creditworthiness of the issuer.
  - 'Capital guaranteed' products, where the product issuer sometimes outsources the capital guarantee to a large bank or other Authorised Deposit-taking Institution (ADI). However, the retail investor may not have the same protections as a deposit account holder with the bank, or a secured creditor of the bank.
- Constant proportion portfolio insurance' (CPPI) structured products which change the allocation of investors' money between defensive and growth assets, depending on how markets are performing. In falling markets, it is possible that the entire investment is placed in cash or a zero coupon bond to ensure capital protection at maturity, but no further investment growth is possible from that point (this is known as 'cash-lock').
- Limited recourse loans with put options, which allow the investor to lock in a minimum predetermined sale price for the underlying investments such as shares, as long as the sale occurs on an agreed date (i.e. the product's maturity date).

- Compulsory loan structured products, which require the investor to borrow the money to be invested, or which create this leverage ‘synthetically’ through derivatives. The lender may be related to (or the same financial institution as) the structured product issuer. In these cases, the capital being protected is the original value of the actual or notional loan, but the investor’s outlay of loan interest and other fees is not protected.
- ‘Capital-at-risk’ (‘yield’) products, where a relatively high annual income is paid to the investor, but return of their capital is subject to prices of the underlying reference assets not falling below a predetermined point. These products are often promoted as having ‘conditional capital protection’.

In its fact sheet ‘Get the facts: capital guaranteed or protected investments’ ASIC identified the following retail investor risks associated with these products:

- The risk that the product will not perform above inflation.
- The risk that under certain conditions, the capital will not be returned in full.
- The risk that the combined costs of the protection, loan and/or advice will be more than any investment gain.
- The risk that in falling markets, some investments will be ‘locked’ as cash so they cannot deliver any further investment returns, even if the market recovers.

Objectives

A key objective of this research was to assess whether investors understood the capital protected or capital guaranteed product they had invested in, or were planning to invest in. A second question was to assess how well retail investors understood the risks associated with these products. If investors had not understood the risks, ASIC wanted to identify whether or not documentation about the investment had been available to the investor, and whether or not that documentation was read and understood.

The specific objectives of the research were to gain in-depth qualitative understanding of:

1. What type of investor had invested in capital protected or capital guaranteed investments.
2. The role these products have played in retail investors' portfolios.
3. Investors' motivation for investing in these products.
4. Investors' comprehension of the various terms and conditions associated with 'guarantees' and 'protection', and their impact on investment decisions.
5. Perceived alternatives to these structured products (e.g. term deposits).
6. Investors' understanding of how the issuer is able to protect or guarantee the return of the capital.
7. Investors' perceptions of the risks and costs of structured products described as capital protected or capital guaranteed.
8. How investors came to invest in these products (i.e. through a financial adviser, seminar, advertising, recommendation etc).
9. The role of disclosure and advertising material in investor decision-making.
10. The effectiveness and shortfalls of the current disclosure practices from the perspective of the investor.
11. Current and past investors' levels of satisfaction with their investment.

Project scope

The scope of the research included structured investment products that are described by product issuers as capital protected or capital guaranteed. The below table outlines the products that were 'in scope' and 'out of scope'.

In scope	Out of scope
'Over-the-counter' (unlisted) structured products described as 'capital protected' or 'capital guaranteed'	Capital secure or guaranteed investment options (funds) offered within public offer superannuation funds
	Retirement Savings Accounts (RSAs)
	Guaranteed retirement income products
	ADI deposits
	Annuities
	Exchange-traded products such as warrants, options, CFDs
	Fixed income investment funds

Research method

The research methodology consisted of two stages:

1. The use of an online research panel to identify and invite investors to interview.
2. Qualitative research methods used to interview eligible investors.

Sample selection

We used the Survey Village online panel to provide the source of the sample. We used an online panel because it provided a cost-effective way to find hard-to-reach investors. It was estimated that there were about 50,000 current investors in Australia, but the number of past investors and those currently considering investing in the products was unknown. It was clear, though, that the population size was small. As many of the products are available online, the risk of biasing the sample towards online users appeared to be very small.

The questionnaire used to initially identify and select investors is attached in the Appendix. The questionnaire asked panel members if they had invested in the past, were currently invested, or were considering investing in 'capital protected or capital guaranteed' investments. The questionnaire also included questions about whether they were retired; whether they had a self-managed super fund (SMSF); and whether or not they used a financial adviser.

Potential participants were then asked a series of questions designed to ensure that the sample contained people who had invested in, or were considering, the class of investment products in the scope of this research project (see page 13). These investors were asked to give the name of the product(s) they had or were intending to invest in. ASIC then confirmed whether or not the products were within the scope of this research.

This selection process yielded about 50 people who appeared to be eligible for the next stage of the research, and who stated their agreement to take part in another interview.

The next step was to select eligible investors to interview. Our aim in selecting the sample for the final stage was to ensure a mix of products, retirees and non-retirees and people who had invested directly or through an adviser. We were also able to ensure that the sample was drawn from across Australia.

Once we had identified our sample, we contacted eligible investors to secure an appointment for an interview. We advised them that this research was being conducted by Susan Bell Research for ASIC.

Qualitative research interview methods

The information-gathering stage of this research used qualitative research methods because our aim was to explore how investors chose and evaluated these products. Since we were interested in personal decision-making, we conducted all interviews individually, as an individual in-depth interview. These interviews were conducted in August and September 2011.

We conducted the interviews using a combination of telephone interviewing and web-conferencing. The web conferencing platform allowed us to show investors some material about the product they had invested in, or a very similar product from the same issuer. In some cases the stimulus material was for an earlier or later tranche of the same product, and it was explained to participants that they would need to check the terms of their specific product. ASIC provided the relevant information. In three cases the respondent could not log onto the web conferencing platform, so the information was sent to them by email.

The individual interviews took between 45 and 60 minutes by phone. In all but two cases, the interview was recorded for later transcribing. We paid investors a cash incentive to take part in these interviews. We assured investors who took part that their anonymity was protected. Permission was given for all recordings. All recordings and transcripts have been de-identified.

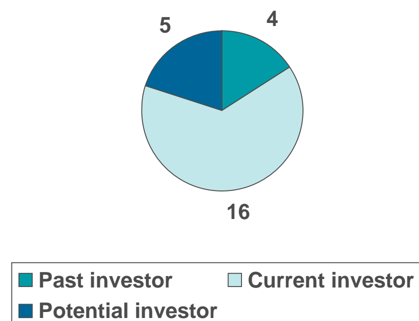
Susan Bell and Megan Price conducted the interviews.

The sample

We conducted 27 interviews, but rejected two afterwards as we believed that the research participants had not in fact invested in capital protected or capital guaranteed products that were within the scope of the research. Therefore the final sample is N=25.

The sample includes 16 current investors, 4 past investors and 5 potential investors.

Figure 1: Current, past and potential investors



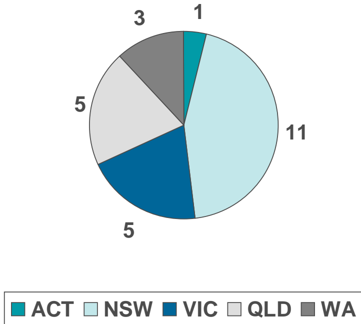
- Five investors had invested during the period from 1997 to 2001. All of these investments had matured. Some of these investors had invested repeatedly. One still had a current investment.
- Seven investors had initially invested around 2004 to 2006. These investments are still running.
- One had invested in 2005 but had withdrawn it early.
- Seven have invested since 2009 and these are all still running.

The investment terms for these products varied. One recently launched product had a 3 year term. For other investors in the study, product terms were 5, 7, 8, or up to 10 years.

To date, most of the investors interviewed for this study had invested in only one capital protected or capital guaranteed investment. However, two people had invested in more than one of these products, some or all of which have matured. In addition, two participants were past or current investors who were currently considering reinvesting.

The sample was drawn from across Australia. Eleven investors lived in NSW, with 5 each in Victoria and Queensland.

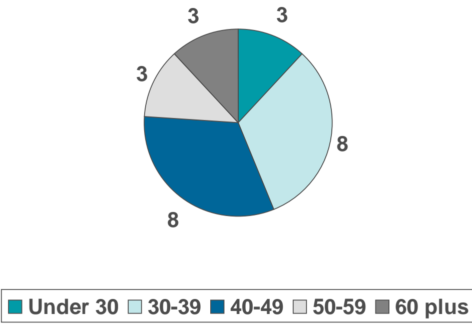
Figure 2: Geographic location



Some Western Australian and ACT investors also took part.

The sample includes investors of different ages. Overall, most (19) were under 50.

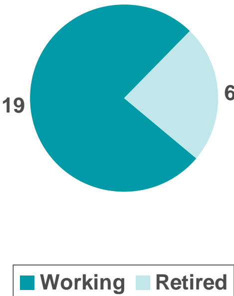
Figure 3: Age of investors



Most investors who took part were in the 30–39 age group (8 people) or the 40–49 age group (8 people). Three investors were under 30, and 3 were over 60.

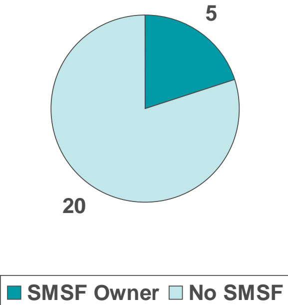
Accordingly, most were still in the workforce.

Figure 4: Working status



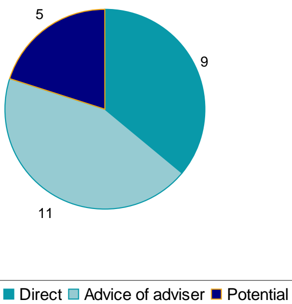
Five investors had a self-managed super fund (SMSF).

Figure 5: SMSF owners and non-owners



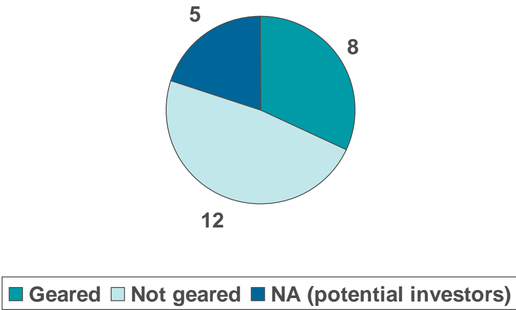
Most of the investors in the sample (11) had invested directly, while 9 had invested on the advice of a financial adviser.

Figure 6: Invested directly or advised



The 5 people in the chart above are potential investors.

Figure 7: Geared investments



Eight investors had borrowed to invest, through the issuer.

B Detailed findings

What type of investor has invested in structured products?

This section describes the characteristics of the investors who took part in this research. It shows that capital protected and capital guaranteed investments have attracted a diverse range of investors, who varied in their experience and their investment goals.

Life stage

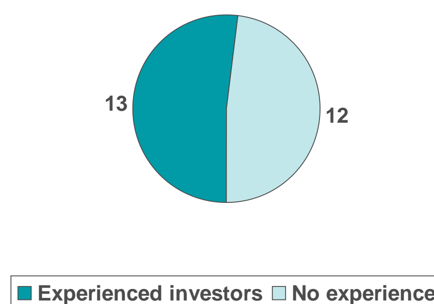
Investors in capital protected and capital guaranteed investments were at different stages of life:

- Young singles, looking for a 'starter' or 'entry-level' investment.
- Couples with children and a mortgage, looking for ways to get further ahead.
- People who had been made redundant, looking for somewhere to invest redundancy packages.
- Pre-retirees and retirees looking to diversify their investments.
- Retirees looking for income in retirement.

Investment experience

Experienced and inexperienced investors have invested in capital protected and capital guaranteed investments. About half the investors in this study had some experience in investing and half had not.

Figure 8: Experience in investing



The experienced investors had previously invested in shares and property. Only one had previously invested in listed investments such as futures, options or warrants.

The inexperienced investors had never invested directly in shares, though most had been or still were property investors and some had invested in managed funds.

> "*Apart from the properties, we don't have any other investments…*" (Current investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

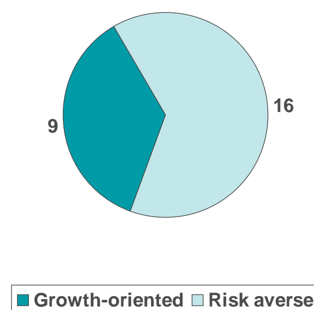
Investment goals

We asked investors their attitude to investment risk and their motivations for choosing these investment products. It was clear from the analysis that capital protected and capital guaranteed products have attracted two very different types of investor.

- Growth investors who were primarily looking for investment growth; and
- Risk-averse or cautious investors whose main desire was to avoid investment losses.

The pie chart below shows that there were 16 risk-averse investors and 9 growth-oriented investors in the sample.

Figure 9: Risk-averse or growth-oriented investors



The investors who chose a capital protected or capital guaranteed structured investment because they expected high performance described their aims as *"performance", "growth"* or *"opportunity".* One described himself as *"adventurous".* (Current investor. Bond plus call product. Retired. Has adviser)

They understood that they needed to take some risks to achieve this growth.

> *"I need to take risks to make the higher return."* (Past investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

On the other hand, most of the investors in the study had the opposite outlook. They were risk-averse and described themselves as *"cautious"* or *"conservative"*.

> *"I consider myself a very conservative investor. I look for safety first ... I like to know the money is there, even if it doesn't earn a lot."* (Current investor. Bond plus call product. Not retired. Has adviser)

> *"I have sufficient resources or sufficient investment funds for my retirement as long as I don't muck it up … as long as I make potential investments and don't lose capital, I think I have enough money so I don't have to chase returns that are very high, to survive…"* (Potential investor. Capital-at-risk product. Not retired. Direct)

Where growth investors looked to the future, risk-averse investors looked to the past, because they either knew of investment losses in the past, or had had some investment losses of their own. They were determined not to lose money. Therefore, when considering and evaluating capital protected and capital guaranteed investments, risk-averse investors focussed on the potential for loss. What was most important to them was that "*regardless*", they wanted to *"get their money back".*

> *"I don't want to feel like I have lost."* (Potential investor. Multiple products. Not retired. Has adviser)

Several people described their fear of investment loss in extreme, black and white terms, talking about the chance of losing their *"whole"* investment on the share market if they invested directly – that it might *"vanish"*.

> *"This is the same as buying a house and a term deposit ... it's not risky and it won't vanish."* (Current investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

> *"It's a fear of watching $20,000 erode away.*" (Potential investor. Multiple products. Not retired. Has adviser)

Risk-averse investors who were introduced to these products by advisers reported that advisers also focussed on removing the fear of a loss, rather than on the potential gain.

> *"I decided last year I was going to retire … so I started to talking to a financial adviser and of course his first comment when he saw the super fund was 'you are terribly conservative' … that is when we stepped through the various options available, bonds, shares, debentures and other forms like that. At that stage capital guarantee loans weren't there and [later] he contacted me and about that time [and said] 'a couple of new things arrived on the scene' so he [suggested] I move money between them. I had discussions with him about what the effects were, what the risks were and where it was and we decided that I think bought some bank bonds and bought this capital guarantee investment ... so my directive to the financial adviser would definitely be to stay away from that end of the investment market and wherever possible make sure the capital is not likely to be eroded quickly or too much if things happen."* (Current investor. Bond plus call product. Not retired. Has adviser)

> *"The financial adviser told us … this was very safe … we were told this is 100% safe."* (Current investor. CPPI product where client used optional borrowing. Not retired. Has adviser)

It is a significant finding of the study that these structured investment products have appealed to people with such different investment styles and that these styles of investing were found throughout the sample for the study. Some of the experienced investors were growth-oriented and willing to take investment risks but so too were some novice investors. There was no difference between growth-oriented and risk-averse investors in terms of the product they invested in – growth-oriented investors were just as likely as risk-averse investors to have invested in any of the products. Among working people there were just as many growth-oriented as risk-averse investors, though among retirees and SMSF owners, most considered themselves risk-averse.

The perceived meaning of capital protection and capital guarantee

What did investors understand by the terms ‘capital’, ‘capital protection’ and ‘capital guarantee’?

The meaning of the term ‘capital’

Most understood the term ‘capital’ to refer to the money that they *“put in”*, a phrase often used by participants. In most cases, the money they ‘put in’ was their own capital.

However, some geared investors did not understand that the interest payments they made for their loans were not considered by the product issuer to be ‘capital’. One investor considered that they were *“investing $8,000 a year”,* and mistakenly, that the $8,000 in interest payments was protected. (Current investor. CPPI product with compulsory borrowing. Not retired. Direct)

Another geared investor stated that she *“invested”* $100,000, though *“we didn’t have to put up the capital.*” Again, this participant’s main outlay was interest paid annually for an investment loan of $100,000.

In both of the above examples, the only ‘protection’ provided was that the principal amount of the loan would not have to be repaid if the investments performed poorly, on the condition that the investor maintained interest payments until maturity. However, none of the investor’s outlay (loan interest) was protected. Neither investor seemed aware of this fact when they originally invested.

Other geared investors understood that the term ‘capital’ referred to the money they had borrowed and not to their interest or fee payments.

The meaning of the term ‘capital protection’

We asked investors what they understood by the term ‘capital protection’. They said that ‘protection’ of the capital meant:

> *“You won’t lose your capital.”* (Potential investor. Multiple products. Not retired. Has adviser)
>
> *“You are going to get your money back.”* (Current investor. Bond plus call product. Retired. Has adviser)
>
> *“You don’t lose what you put in initially.”* (Current investor. CPPI product with compulsory borrowing. Not retired. Direct)
>
> *“If you are investing an amount like 100 and regardless you will get a return of 100 or it may go up…you will always get that 100 back.”* (Current investor. Bond plus call product. Not retired. Has adviser)

All referred to either having the original investment returned intact or *“not losing”* it.

As can be seen, almost all answered with words that suggested certainty and security, which suggests that when used with the word ‘capital’ in the context of investment investors interpret the word ‘protection’ in absolute terms – ‘unconditionally protected’.

When they were interviewed, and when they originally invested, all the investors in this study with capital protected products expected to get *"100%"* of the money they invested back when their product matured. For example, the following investor had a product marketed and labelled as protected rather than guaranteed. Nevertheless she stated:

> *"It was guaranteed."* (Current investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

The meaning of the term 'capital guaranteed'

The researchers then asked about the meaning of the phrase 'capital guarantee'. The majority of the investors interviewed considered the phrase capital guarantee to mean *"the same" or "close to the same thing"* as capital protected.

> *"I hadn't given a lot of thought to them being separate."* (Current investor. Bond plus call product. Not retired. Has adviser)

Figure 10: The perceived overlap between the terms 'capital protection' and 'capital guarantee'

The perceived overlap in meaning for most investors is illustrated in the diagram above. For most, both terms meant 'you will get back what you put in'.

However, six people changed their minds during the interview, because our questions had made them think more about it. Although they had originally considered it certain that a 'capital protected' investment would be returned complete, they changed their minds when we asked about the meaning of 'capital guarantee', saying that 'guarantee' was a stronger word than 'protection'. They described 'guaranteed' as:

> *"Rock solid."* (Potential investor. Internally geared product. Not retired. Direct)

> *"Written in stone."* (Current investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

> *"Hard and fast."* (Past investor. Bond plus call product. Not retired. Direct)

They then went on to describe ‘protection’ as:

> *“They will do their best.”* (Past investor. Bond plus call product. Not retired. Direct)

Some of these investors understood that in the case of a ‘guaranteed’ investment an entity – specifically the bank – was standing as guarantor.

> *“You will always get your capital back even if they crash.”* (Current investor. CPPI product with compulsory borrowing. Retired. Has adviser)

> *“The bank is willing to bear the cost or losses.”* (Current investor. Internally geared structured product. Not retired. Direct)

There were no noticeable differences between novice and experienced investors in terms of their understanding of the words protection and guarantee.

For some investors however, their understanding of this term has changed since they originally invested. Somewhat bitterly, one investor stated that

> *“What my understanding is banks can do anything to protect their money but they don’t necessarily care about yours.” (*Current investor. CPPI product with compulsory borrowing. Not retired. Direct)

This investor discovered that she has paid a considerable sum in interest payments for an investment that will have no value at maturity.

In sum, the research suggests that investors may easily presume that capital protection means ‘guaranteed’ until prompted to think about any differences.

Understanding the protection conditions

As we have seen, whether defining guaranteed or protected investments, investors spoke in absolute terms. Similarly, when asked in the interview specifically about any ‘conditions’ that would apply to the return of their investment, some stated that there were none.

> *“In the one that I am involved in there are no conditions … if I found there were conditions with it, I would have to know what the conditions were and then what the risk factors were with those conditions. And I am not sure if you call it capital protected if it had a risk of actually losing capital. Going to be capital something or other and 90% protected or something, I have no idea, but I wouldn’t see that as fully capital protected.”* (Current investor. Bond plus call product. Not retired. Has adviser)

Nevertheless, some of these investors were aware that they might not receive all their money back if they chose to redeem early but tended to treat this as a minor potential problem. The strength of their conviction in the capital protection or guarantee that they would get “*everything*” back seemed to over-ride their understanding of everything else.

Although the conditions on protection vary from product to product, there were no differences between investors in the different products in the responses to this question.

As this discussion has shown, investors in capital protected products chose their investments because of the capital protection. Our analysis has shown that some investors did not fully understand the conditions on this protection. This occurred largely because investors presumed that by its very “*backing*” of a trusted bank, the investment was effectively guaranteed.

What motivated investors to invest in structured products?

Investors perceived that capital protected and capital guaranteed investments gave them a number of different benefits:

- Protection from loss, and
- Investment growth.

And for some investors, these products were also expected to deliver:

- Easy 'set and forget' investing
- Diversification
- Investment income
- Easy gearing and/or
- Tax deductibility.

These are all explained in more detail below.

Protection from loss

Investors in this study were motivated to choose capital protected or capital guaranteed investments to protect themselves from losses.

> *"I felt that if something terrible does happen, we have got some sort of protection against losing everything."* (Current investor. CPPI product with compulsory borrowing. Not retired. Direct)

Investment growth

How important was investment growth to these investors?

The first section of the report has described some investors as growth-oriented and some as risk averse. This might suggest that only the former type of investors were seeking growth from their investments. However, this is not the case. Just as all investors in these products expected loss protection, all expected investment growth as well – the growth-oriented investors just wanted more of it, as described below.

Expected performance growth-oriented investors

Growth investors expected the product to perform extremely well. They were seeking growth from this investment and therefore expected a return above what they could expect from other investments.

> *"It could double or triple or quadruple, that is 400% more than what I started with and it is all possible. Which term deposits can't do as it is whatever the interest rate you started off with."* (Current investor. Compulsory loan structured product. Not retired. Direct)

One thought it would *"turbo charge the amount of money you could make rather than 5% to 6% a year you could make 50% to 100% in a reasonably quick amount of time."* (Past investor. Bond plus call product. Not retired. Direct)

For these growth-oriented investors the capital protection helped them take more of a risk. They were typically investing more money than they had in the past. The protection was the "*icing on the cake".* (Past investor. Bond plus call product. Not retired. Direct). It helped to *"calm people's nerves"*. (Past investor. Bond plus call product. Not retired. Direct).

Expected growth for risk-averse investors

Although risk-averse investors thought mostly about avoiding investment loss, they were also seeking some growth. They were effectively seeking a better investment return than was offered at that time on term deposits. The ideal return was perceived to be any amount above the term deposit rate. Their actual expected return varied with the year in which they invested, but was typically around 10% to 12% per annum.

Expectations of a guaranteed return

Some products offered investors a form of guaranteed return.

> *"You are guaranteed to get a certain amount back and it will actually increase with the investment. If they are doing well with our investment, then they will levee up a little bit and they will guarantee to give you your capital back plus a bit of profit back and it will hold there and it will keep going".* (Current investor. Bond plus call product. Not retired. Has adviser)

This did indeed work out as planned for this investor. However, some expected a gain but their expectations were dashed because their investment went into cash-lock. Of these, one had expected to "w*alk away with 120% of the original investment"* (Current investor. CPPI product with compulsory borrowing. Not retired. Has adviser). For another:

> *"There was a guaranteed return definitely as I understood … I think something like 1.2% of your initial investment is your guaranteed return then obviously of that return you have to take off your initial investment and then there is a remaining growth that they guarantee so for instance if you invest around 20 you have minimum guarantee of 22 but of that 22 you have to pay back the 20 and then the minimum is $2k."* (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

Some product issuers did not mention any specific return in their documentation, though their advisers had used projections during the advice process. One couple who were paying annual interest on a $100,000 investment loan, for example, were told they could expect *"half a million"* in profit after 8 years (Current investor. CPPI product with compulsory borrowing. Not retired. Direct), based on the advice they received. Others cited expected gains of about 12% to 15% pa.

Other investors correctly understood that the gain was not guaranteed. Nevertheless, they expected to receive all the gain that the product achieved.

Restrictions on the gain

Some products impose conditions on the investment gain that can be paid to the investor. For example, one bond plus call product option that paid a 5% annual coupon for its five year term (25% in total) would only deliver an additional capital gain if the underlying assets increase by more than 25%.

One investor in these products understood this, but others had no understanding that there were any conditions on when or whether they would receive any investment gain.

> *"In today's market that investment whilst it has capital protection in it ... you wouldn't be getting a lot ... because you are looking at the share market in the last 2 and 3 years, the share market really has gone nowhere so in some cases you will not get your 25% growth. So if you invested*

today it would only be attractive for the capital protection not for the capital growth side of it." (Current investor. Bond plus call product. Not retired. Has adviser)

Easier investing

These products also seemed to offer inexperienced investors an easier way to invest. Several described the perceived benefit of convenience. For them, these products demanded less effort from the investor than share investing.

> *"You don't have to do all the research and [that] takes big time."* (Current investor. Bond plus call product. Not retired. Direct)

> *"I can play in a pool without putting too much at risk and without having to study a field that I know very little about."* (Potential investor. Internally geared product. Not retired. Direct)

Diversification

One of the key reasons for some experienced investors to choose a structured product was the perceived need to diversify their portfolio. These investors already had property and share investments and believed that they needed to invest in another product type.

Diversification seems to be an unquestioned 'rule' of investing. As one pointed out, the media *"tells"* people to diversify investments. *"When you go on SMH or whatever you read business things, like any point in time, 'you need to invest and diversify' and things like that".* (Current investor. CPPI product with optional borrowing. Not retired. Direct)

Income

Some products provide a dividend or income throughout the investment period as well as the promise of growth when the investment matures. This was a driving factor for one self funded retiree who was looking for a combination of growth and income.

> *"As self-funded retirees, income is very important to us, but to also have the capital preserved."* (Potential investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

This investor had had a previous experience with a different kind of product where the income was no longer available because of a 'knock out event'. This time, he took this into account and has checked the issuer's product fact sheets – but not the PDS – for this information.

Gearing

For some investors, the possibility of a geared investment was a core benefit of the product. Borrowing was perceived to *"turbo charge*" their investment. (Current investor. Bond plus call product. Not retired. Has adviser)

The people who borrowed money to invest deliberately chose a capital protected product so as to avoid owing more money than the investment was worth, if the market dropped.

> *"I had to borrow to invest and therefore wanted to protect myself in the case that I didn't lose everything."* (Past investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

Note again the use of extreme terms: *"everything".*

Before investing, no one compared the interest rate they were paying with that offered elsewhere. Only one geared investor calculated her ability to repay if the interest rate went up. Another was assured that loan payments would be less than the investment gain, though in fact the opposite occurred to some people.

> *"We didn't have the amount in cash to invest ... when he sold it to us we were told we would pay less interest on the investment than we would make so it was sold to us as a positive move. Having said that we are actually making less than the interest is costing us. By the initial [way] he was talking we should take out about $60k profit or something like that, but we are not going to get any profit." (*Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

None of the others considered the effect of an interest rate increase would have – though one did after the investment matured. One claimed to be paying 3.3% interest on her loan, so was confident that her return would exceed that.

In the days of rising markets before the GFC, investors found it hard to imagine that their returns would not exceed their interest payment significantly.

As the report shows, risk-averse investors were thinking more about loss than growth when they made their original decision to invest. Nevertheless, they expected their investment to grow at above the term deposit rate. Other more aggressive investors expected high growth. Some chose to gear their investment to achieve this.

Tax deductibility

Three investors were motivated to invest because they saw it as a way to reduce their tax.

> *"Apparently 80% of this product is tax deductible, which was another sales point."* (Current investor. CPPI product with compulsory borrowing. Not retired. Had adviser)

Some advisers had promised them this benefit.

> *"Part of the reason we set up this investment was … to offset tax and that was part of the advice given."* (Current investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

Another believed they could *"delay"* tax, because they did not receive an income until the product matured. The way they described that they are able to do this – in theory – was to receive their capital gain in a year which is favourable for them to do so. (Current investor. Bond plus call product. Not retired. Direct)

Tax deductibility was only relevant to geared investors, but not all geared investors regarded it as important.

How well did investors understand the product?

The Project Background section of this report has described some of the ways different capital protected and capital guaranteed investments vary in their structure. These differences have implications for the kinds of conditions that must be met for the protection or guarantees to apply. This section therefore describes how familiar investors were with the products they had invested in or were considering.

Using the web-conferencing platform, the researchers showed investors some extracts from publicly available information on the product in which they were invested, or similar products from the same issuer.

The key issues are whether investors understood:

- The investment strategy
- The investments risks
- The key product features
- The costs and fees.

Understanding of derivatives and the investment strategy

This section explains how well investors understood how the capital protected or capital guaranteed product 'worked', what the investment was, and how the issuer was able to protect or guarantee the capital.

Overall, experienced investors understood their investment better than novice investors. Experienced investors generally understood that *"you have to go into this with your eyes wide open"* because they knew that the product was based on a method of investment which some of them described as *"exotic".* They knew it involved one or more of:

- Hedging
- Short-selling
- Option and futures.

> *"It's investing off markets in futures and options."* (Current investor. Bond plus call product. Retired. Has adviser)

Most experienced investors believed this from the time of their initial investment. As one said *"theoretically, it should work."* (Past investor. Bond plus call product. Not retired. Direct). The basis of it is that "*if one particular investment falls, it balances out, you will get higher returns versus lower returns.*" (Potential investor. Internally geared product. Not retired. Direct)

They also commented that they did not know much about what this meant in practice. Some reported that the product issuers or advisers had not explained the products well in these terms. Speaking of his conversations with a product issuer, one investor commented:

> *"The best they could tell me was that it was a good options play, but I don't think they knew in detail exactly how it works."* (Potential investor. Capital-at-risk product. Not retired. Direct)
>
> *"It could have been straddling values of gold, it was a little bit vague on that, like 'we have got this great track record and don't worry about details on how it is going to be done'."* (Past investor. Bond plus call product. Not retired. Direct)

This lack of effective information about how the products work means that even experienced investors *"are taking someone on blind faith".* (Past investor. Bond plus call product. Not retired. Direct)

> *"If I invest my money and somebody says 'we will pay you 12%' I want to know how they are going to earn 12%. If I don't believe they can earn 12% then I get very suspicious, because I think in the past where people have been caught out is where they have been promised very high rates of return which had been unrealistic and the issuers simply haven't been able to do what they had suggested they would be able to do.*" (Potential investor. Capital-at-risk product. Not retired. Direct)

However, inexperienced investors generally understood almost nothing about the product. It is clear that many novice investors conceptualised the product as if it was a managed fund or share portfolio.

> *"They were just shares."* (Current investor. CPPI product with compulsory borrowing. Not retired. Direct)

> *"Blue chip shares." (*Potential investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

> *"Managed fund type things."* (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

> *"A managed fund arrangement."* (Potential investor. Bond plus call product. Not retired. Has adviser*).*

In fact the investor may not buy the actual shares or units in a managed fund, but rather a promise that the institution would pay a return based on the performance of those shares, often using derivatives to achieve that return.

Accordingly, these inexperienced investors stated that higher investment gain would occur because of the investment skill of the fund manager, in whom they had faith.

> *"I put my faith in fund managers to get a good return."* (Current investor. Bond plus call product. Not retired. Has adviser)

> *"They use their management skills and expertise to make prudent decisions to grow your nest egg."* (Potential investor. Multiple products. Not retired. Has adviser)

Some novice investors had been told that the investment used put options but did not know what this meant.

> *"Put options puts money in the bank and protects it from any share market fluctuations."* (Current investor. CPPI product with optional borrowing. Not retired. Direct)

Two of the 25 investors realised that their investment used derivatives. The rest were completely unaware of whether derivatives were used. Indeed, some specifically stated that they had never heard the term before. Some had heard of derivatives but did not want to use them.

> *"I have a vague idea, but I don't really look at those sorts of things."* (Past investor. Various bond plus call products. Retired. Direct)

> *"I would stay away from them."* (Current investor. Bond plus call product. Not retired. Direct)

> *"I would steer clear of them."* (Potential investor. Bond plus call product. Not retired. Has adviser)

Investors’ understanding of investment risk

This section explores what investors did or did not understand of the risks they faced as investors in capital protected and capital guaranteed investments.

Understanding general investment risks

When asked about the investment risks they considered for these investments, most investors answered in terms of general risks, such as

- The risk that the bank or the issuer could collapse.
- The risk of fraud or poor management of the investment.

When asked to nominate the risks that investors in these products could face, most thought that the greatest risk was if the product issuer or the bank which was standing as guarantor collapsed or *“went belly up*”, a risk which they regarded as small.

Investors placed their faith in the size and stability of the issuer or bank.

> *“If the bank goes bankrupt you might lose your capital, but most of the times it would be guaranteed.”* (Current investor. Bond plus call product. Not retired. Direct)

Some thought that they might receive their capital back even if the *“investment goes completely wrong”* (Potential investor. Internally geared product. Not retired. Direct)

Some were also aware of general investment risks, such as the risk of fraud or poor management.

Understanding the impact on personal circumstances

However, investors tended not to think about the consequences on their own financial position from less extreme events, such as lifestyle changes. For example, some investors realised after they invested that a long-term investment was unsuitable for their stage in life. Two of these investors invested before buying their own home and having children. When they did take on a mortgage and had started their family they discovered that their cash flow needs had changed.

One of the lessons learned from this research is that Australian investors will become better informed if they are encouraged to think about the implications of their investment choices on their potential lifestyle or circumstances.

Expected risk and return

To understand why both growth-oriented and risk-averse investors have invested in similar products, we need to explore the different ways that these investors perceived risk. Risk-averse and growth-oriented investors seemed to understand the risk-return relationship differently.

One of the keys to understanding investor behaviour is to understand how investors trade off perceived risk against expected return. In this category, investors seemed to see the relationship between risk and return differently depending on their understanding of risk.

Growth-oriented investors expected that the potential return would be high. They also equated higher return with higher risk.

> *“I saw it was risky ... I looked at the graph and could see how it jumps up and down, but it had the opportunity to jump up a great deal more than property would, so it was more volatile and had the*

potential to increase greatly and that was appealing." (Current investor. Internally geared product. Not retired. Direct)

In contrast, risk-averse investors did not perceive that they were taking a risk when investing in these products, because

- They equated risk with volatility and assumed that the capital protection or guarantee had removed the volatility, and
- They did not expect the return to be high.

They saw it as *"moderate return, low risk."* (Current investor. CPPI product with compulsory borrowing. Retired. Has adviser)

> *"It wasn't like it was a high risk strategy. Only a general 10% sort of ... and I thought, that is not being ridiculous. If it had been 40%, we would have gone 'I don't think so'."* (Current investor. CPPI product with compulsory borrowing. Not retired. Direct)

It was as if the normal rules did not apply because *"there should be no risk"*.

Risk-averse investors thought of direct share investment only in terms of potential loss, not potential gain, so they had no idea what kind of return could be expected from direct share investing. Therefore, they were unable to judge whether the expected return from capital protected or capital guaranteed products was any different from that offered by share investing. They also seemed unaware of the kinds of returns that could be expected from (say) managed funds. Consequently, there was no signal to them about whether the product was riskier than investing directly in shares.

One experienced investor considered the guarantee to be "*a way of pitching an exotic investment to people so they feel the risk isn't there, as long as you are willing to give it time.*" (Past investor. Bond plus call product. Not retired. Direct)

Time value of money

We asked investors what they understood by the term 'the time value of money'. No one understood the term. When we explained it as the effect of inflation, most people did understand it.

No one had seriously taken it into account when they invested. When it was raised during the interview, most investors recognised the potential impact, but tended to treat it fairly lightly.

What would perhaps be more meaningful is an illustration of how the effect of inflation can compound over a long term investment.

Understanding key product features

Understanding cash-lock

One feature of some products is that the investment may go into cash-lock, which means that the investment has been placed effectively into cash – and will not be invested for further growth. Fees may continue to be taken out of the amount invested.

Those investors whose investments did go into 'cash-lock' were unaware before it happened that this could occur. In fact, they did not seem to realise that it had happened until they received notification that they could *"buy out":*

> *"Something we found a little frustrating was, I know it had been performing quite poorly, but they changed the whole investing thing where some people could buy out at a percentage but if you*

don’t have $6K upfront you couldn’t buy out.” (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

*“Only 3 or 4 months ago, we got a letter from [the product issuer] making us an offer to do, redeem and payout the loan or do nothing or participate in another fund and transfer everything over to another one. We chose to do nothing ... where it sits in all the paperwork, it is not sitting in a very strong financial position. And we decided it was better for us to stay in it because we weren’t going to lose out too much.” (*Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

The only participants who were aware of potential risks specific to these products were the people who had already experienced problems with them.

Early redemption

Many investors were aware that they would pay a fee of some kind if they decided to withdraw their investment early. The usual view was that early redemption would be allowed and that there would be a small price to pay for doing this.

“If I want the money I can sell my investment, but they take a little cut.” (Current investor. Bond plus call product. Not retired. Direct)

In fact, early withdrawal fees can be significant and capital protection generally doesn’t apply if investments are not held until maturity. A more experienced investor recognised that there could be problems with this.

“For whatever reason, be it health reason or you lose your job or other form of financial difficulty, if I need to pull that investment out early what are the ramifications? What do I get if I invested say $100k? Does it mean I will only get $50k out? And what happens with the rate of return? You invest in the share market and you might make 20% over 5 years, but if you need to pull it out on a certain day then you could make a negative 20% and that is your risk.” (Current investor. CPPI product with compulsory borrowing. Retired. Has adviser*)*

One investor had tried to withdraw early but had not been allowed to:

“In one year, we had an issue where we were struggling a little bit financially and we rang them and the reception that we got was quite closed and quite cold and there was nothing they could do about it we were locked in and that is the risk because if you do in that 8 years at any point in time whether finances are a bit tight they didn’t actually care at all. And so they actually took $10k out of the account and put the accounting into $10k into the red. They don’t really care.” (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

Withdrawal on the exact date

Some investments must be withdrawn on the exact maturity date, for the protection to apply. One investor in a product with this feature did not know about it.

“I thought the capital protection was there forever.” (Current investor. CPPI product with optional borrowing. Not retired. Has adviser).

One investor admitted that *“we never studied the whole terms and conditions.” (*Current investor. Bond plus call product. Not retired. Direct) and so was unaware of this condition.

Understanding product costs and fees

Some products have upfront fees. Most investors however stated that there were no fees, or if there were they came out of the return. They did not know what these fees were. According to one potential investor who has looked into the product in some detail:

> *"The fees are not transparent to anyone who buys the product."* (Potential investor. Capital-at-risk product. Not retired. Direct)

This investor was one of the few to think about the implications of fees being taken out of the investment return, guessing that the investment would have to gain about 12% a year for it to deliver the promised 8.25% pa.

One current investor knew the fees were 3% "*but didn't know it was going to add up*" – especially in her case as the product has been suspended.

Past investors have a different perspective on fees, because they have been able to gauge what the impact of the fees has been. One repeat investor would now not invest again because she believed that she was paying layers of invisible fees out of her return.

> *"It's funds of funds now and fees on top of fees. There is less opportunity for gain.*" (Current investor. Various product types and issuers. Not retired. Direct.)

Another has now realised that the impact of fees is most significant when the investment performance falters.

> *"Management expenses and whatever licence fees it comes from your money so basically if the fund is not making money you get even less because of the expenses."* (Current investor. Bond plus call product. Not retired. Direct)

Why did investors choose these products over other investments?

Why did investors choose capital protected or guaranteed investors when they could have put their money in a term deposit or invested in shares or property?

Essentially, investors chose capital protected or capital guaranteed investments because they believed that the product:

- Filled a gap in the market
- Seemed familiar and easy to do.

This next section discusses these points in more detail.

Met a gap in the market

> *"I was excited. That I had found a solution to what I was looking for." (*Past investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

Fundamentally, these investors were looking for a stable investment with growth rates above term deposits. The following analysis shows that these investors wanted to invest but were dissatisfied with or uncertain about the traditional alternatives: term deposits, shares and property. This was an *"exciting"* opportunity for them.

More growth than term deposits

The investors in this study rejected term deposits in favour of structured investments, because they were deliberately seeking an investment return above the term deposit rate. Basically, the term deposit was seen as the standard to beat.

As one person put it, if you didn't seek investment gain *"you might as well just put your money in the bank."* (Past investor. Bond plus call product. Not retired. Direct).

It is as if investing in term deposits is not trying hard enough as an investor. Investors feared that they wouldn't *"keep up"* if they left their money to *"just sit"* in the bank.

> *"For every dollar I put in a term deposit it is not working half as hard or getting quite the return it could be."* (Potential investor. Internally geared product. Not retired. Direct.)

> *"Fixed term deposits didn't have the potential upside as much. Each fund showed the potential to increase more than a fixed term deposit would."* (Current investor. Bond plus call product. Not retired. Has adviser)

Another research participant talked about a *"plain old term deposit."* (Potential investor. Bond plus call product. Not retired. Has adviser)

The way these investors described term deposits reveals a conflicted attitude towards investing. On the one hand they wanted safety and security, which they found in terms deposits, while on the other hand they were highly critical of term deposits as yielding little more than the inflation rate.

Investors implied that putting money in term deposits is not 'really' investing, whereas putting money in capital guaranteed/protected investments seemed to be true investing. It does seem that people felt a cultural imperative to invest.

> *"The culture is that people are saying you need to invest."* (Current investor. CPPI product with optional borrowing. Not retired. Direct)

More stability than direct share investing

Most of the risk-averse investors chose capital guaranteed or capital protected investments instead of investing directly in shares. They wanted to avoid direct share investing because they:

- Had no experience in share investing,
- Believed that direct investing was difficult. They believed that they would need to spend time learning about shares and the share market. They would also have to actively monitor their investment, and
- They characterised direct share investing as having the potential for *"huge"* losses.

They perceived the share market to be volatile, and felt that they themselves did not have the ability or the time to invest in it well.

> *"I can't risk my future on the volatility of the share market."* (Potential investor. Internally geared product. Not retired. Has adviser)

These investors' attitudes to share investing are characteristic of the 'black and white' thinking that we have noted before.

Access to international markets

A few investors wanted exposure to international markets but were reluctant, or unable, to trade directly. Some of these structured products have given investors access to overseas markets, especially to Asia.

> *"I didn't really want to get involved in overseas trading."* (Current investor. Internally geared product. Not retired. Direct)

Smaller outlay than property investing

Some of the investors in this study had learnt about capital protected or capital guaranteed products at property investment seminars. Their first preference was for property investing because they perceived *"bricks and mortar"* to be safer. However, they believed that they did not have enough money to invest directly in property.

> *"We wanted to invest in property but we didn't have enough cash and this was the next best thing and it was sold to us as a win-win."* (Current investor. CPPI product with compulsory borrowing. Not retired. Direct)

Others already had property investments and believed that they should diversify into a non-property investment, but were unwilling to invest directly in shares.

Seemed familiar and easy to do

Many the investors commented that investing in structured products was a relatively easy process. One of the major benefits for some products was that they were issued by, or were backed by, familiar Australian banks.

Many of these investors – including those in protected investments – believed that their investment was protected by the bank and therefore had faith that the bank would effectively 'pay up' if there was a problem.

> *"The seminar presenter ... described how the capital guarantee was backed by [an investment bank] and how confident they were in the [bank] to uphold their lending."* (Current investor. Internally geared product. Not retired. Direct)

> *"Being so large, the bank is able to lock in the capital.*" (Current investor. CPPI product with optional borrowing. Not retired. Direct)

Knowing that the bank was large enough to withstand any investment losses the investment made was important to investors. Indeed some made the decision to invest because of the backing of the bank.

> *"We were told that [the bank] was a very good company, and trustworthy with their investments and it would go well."* (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

> *"I don't know how it works. I trust the [bank]."* (Current investor. Bond plus call product. Not retired. Direct)

One person believed that the 'guarantee' from the bank for bond plus call products was iron clad, because *"ASIC and APRA can assure the repayment." (*Current investor. Bond plus call products. Not retired. Direct)

This illustrates a common misunderstanding of these investors since the capital protection was an unsecured obligation of the bank to the investor, rather than secured against specific assets of the bank, or subject to the Australian Government's Financial Claims Scheme which protects some deposits at Authorised Deposit-taking Institutions.

In many ways, investors treated their investment, especially if they invested directly, as if it was similar to other retail banking products. They expected the same kind of customer service as they would receive as retail bank customers.

The decision process

This section describes the process that investors used when they decided to invest in capital protected or capital guaranteed investments starting with how they learnt about the products, and then covering any evaluation or comparison they conducted.

How investors learnt about the products

Investors learnt about these investments from:

- Advertisements in magazines – especially for the early bond plus call products.
- Direct promotion to the investor (especially to announce further series for an existing investor to consider).
- Property and investment seminars.
- Issuer websites, and/or
- Financial advisers, planners or brokers.

In the early years of the original bond plus call investments, investors said that they responded to advertisements in magazines and newspapers. Some of these investors then invested in later series of the bond plus call investments when they were promoted by direct mail.

More recently, some investors had come across the products at seminars. Some of the seminars provided a consultant who then explained the product to the investor.

A few bank customers learned about the products through marketing by the issuer on their websites.

Consultation by investors who bought directly

Very few investors who invested directly consulted anyone about their investment. They said that this was because:

- There was no perceived need since the products appeared to the investor to be relatively straightforward.
- A perception that the products were new or unusual, so that investors did not expect any one else to know about them.

Information seeking before the investment

Information-seeking behaviour has changed since the first of these investments were launched in the 1990s. Investors then had very few opportunities to gain any information, except perhaps from investment magazines, or through financial advisers.

Nowadays, potential investors have the opportunity to use Google or other resources to find information, searching for ‘capital protected’, ‘capital guaranteed’ or perhaps ‘safe investments’. A few potential investors have done this. However, most relied exclusively on the information provided by the issuer, which they regarded as sufficient.

> *“I didn’t compare much before. I go through and sounds good to me and like okay, I will go with it.”* (Current investor. Bond plus call products. Not retired. Direct).

No investors had looked at ASIC’s Fido or MoneySmart websites for this information.

Reasons for not comparing products

Four impediments to comparing products emerged from this research:

1. Investors could only invest in the current issue of these products, so unless other issuers released a new series at the same time, investors were not in a position to choose.

2. Investors had sometimes been placed under time pressure by the issuer, so had to decide in a short time. They seemed to focus during this time on whether to invest in this style of product – and if so how much to invest – rather than on the availability of different products.

   *"There was a bit of a rush to get into it." (*Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

   *"I thought I would miss out on an opportunity. This was my chance to invest." (*Past investor. CPPI product with compulsory borrowing. Not retired. Has adviser*)*

3. Difficulty reading the information. Investors told us that the detailed information was too time consuming for them to read about one product, let alone more than one.

4. As described below, none of the investors understood enough of the product features to compare one type against another.

Repeat investing

Several of the investors had invested in more than one series from an issuer. A couple had also invested, or were considering investing in a subsequent series from a different issuer.

In most cases, the decision to re-invest was made about a year or two into the initial investment. Investors felt that they had sufficient information by then to judge whether or not reinvest. One of the reasons for doing this was that some people had chosen to invest a relatively small amount the first time to *"put their toe in the water",* and subsequently had more money to invest.

If they were in that position, the criterion they used to decide whether or not to reinvest was the early returns – either the dividends paid to them during the year, if the product was structured that way, or on the data provided by the issuer in their statements or on their website.

Some potential investors have spent some months thinking about whether to invest in these products, while others were influenced by the deadline to make their decision quickly.

The role of advice

Professional financial advice has played some role in the adoption of capital protected and capital guaranteed investments. Nine investors in this study were advised to invest by a financial adviser. In most cases, the investor considered themselves to be cautious and had spoken to their adviser about their reservations about the share market or other investment alternatives. The adviser then suggested a particular product within this category.

This group of investors varied in age, life stage and in investment experience, and in many ways were very similar to investors who invested directly.

In terms of their experience, investors with advisers and direct investors had similar experiences when they purchased the investment. They seem to have read or looked at the same kind of written material, although in some cases perhaps read less than the direct investors. The main difference was that the adviser provided a 'channel' through which investors became aware of the products.

In terms of advice or information provided, the advisers had provided reassurance. The advisers told their clients that the investments were "*safe*" and backed by major banks. As far as their clients can recollect, the advisers had not explained the conditions on withdrawal or investment gain, however.

The advisers seemed to differ in their approach to some degree. Some of these investors were certainly aware that the investments used futures, options and hedging and may have learnt this from an adviser. Other advisers however seem to have focused more on building trust in the brand, than conveying product details.

> *"We hadn't heard of it ... the financial adviser recommended it to us and it was sold to us as being a very good company and trustworthy with their investments and it would go well."* (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

Some of these advisers may not have been very knowledgeable about the products. Several investors mentioned that the advisers had not provided much detail about the workings of the investment.

> *"The financial advisor had said their clients had them for some years and were happy and I didn't speak to them or anything like that I was just told by him."* (Current investor. Bond plus call product. Retired. Has adviser)

A few of these clients now feel dissatisfied with their financial adviser because they only became aware of the workings of their product some time after they invested. It has not always been the 'win-win' they were expecting.

> *"You invest in these things because the adviser wants you to rather than why you might want to."* (Current investor. Bond plus call product. Not retired. Has adviser)

Some of these advisers also recommended other products that encountered problems during the GFC, such as plantation investments. One adviser recommended structured products at the same time as an earlier investment was "*going belly up*".

> *"He still encouraged us to borrow more to get into this one.*" (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

Four of these investors with advisers had geared their investment. Three of these investments were taken out before the GFC and these investors have been the most dissatisfied of all, because the investments have gone into cash-lock leaving the investor obligated to keep making interest payments. Nevertheless, some investors were satisfied with the investment and the advice they received.

How well did disclosure work?

These are complex products which some people have invested in directly. As such the disclosure documentation needs to inform investors about the product design and its inherent risks and costs. This section discusses whether that information was in a form that was readily accessible to the type of investors who have been attracted to these products.

The original documentation

All investors had received some written information when they originally invested. For most, this was fact sheets or information sourced from the issuer's website. All investors told us that they had read or looked at this kind of information.

A few said they had received the PDS or prospectus. Some had tried to read these, but few had read all of the documentation they were given. Many spontaneously complained about the size of the PDSs – hundreds of pages, depending on the product – a "*small bible"* to one person.

> *"I will be honest with you when you look at some of the product disclosure statements they go on for up to 80 or 90 pages and I have to be honest I don't read the whole lot. I tend to skim through them and now virtually most of the companies don't use a printed prospectus or product disclosure statement. It is virtually all online and to sit there and go through page after page online is not as easy as what it was when there was a printed product disclosure statement."* (Potential investor. CPPI product with compulsory borrowing. Not retired. Has adviser)

> "*Only the prospectus, we went through the prospectus and tried to get a handle on what they were doing. I didn't fully understand because I didn't fully understand the idea of futures and how they were doing it, but the idea sounded pretty good."* (Current investor. Bond plus call product. Retired. Has adviser)

Some also spontaneously expressed concern about the difficult language used, with one describing it as *"riddles".*

> *"I didn't read through the whole book and the data they used was quite complicated.*" (Current investor. CPPI product with optional borrowing. Not retired. Direct)

Using the web conferencing platform, the researchers showed investors extracts from some of the documentation relevant to their product (or a related product) and asked them if they had seen it before and if they could explain it. While most said the basics of the information were familiar to them, many people did not recollect seeing the details.

Many people struggled with the wording, specifically having no understanding of terminology essential to their particular product, such as:

- Zero coupon bonds
- Reference level, and
- Leverage.

It would seem that the written material had not effectively conveyed the product features and risks to these investors.

Ongoing documentation

Some recent products allow their investors to go online to monitor their performance.

> *"I can go online and look at how it is performing."* (Current investor. Bond plus call product. Retired. Has adviser).

However, several investors expressed dissatisfaction with the documentation they received after they invested a few years previously. One commented that the statements list all the series of investments together so it was hard to identify which was their investment. (Current investor. CPPI product with optional borrowing. Not retired. Has adviser).

> *"We couldn't tell how much money we were making, this was initially we would look at it and there was all these figures and it wasn't at all clear where we were at. At the end of the financial year we would just get a whole lot of blur."* (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

Similarly, others said it was hard to know what the current value of the investment actually was.

> *"They do tell you 'this is your protected value', this is where it is, but doesn't actually highlight which one you are [invested in] and it is obvious to me when you look at it, that some of their present value is less that current protection level. I find that a little bit confusing."* (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

Some had received letters after their investment had been gone into cash-lock, giving them the option to redeem, reinvest or stay where they were. In fact, it seems that investors only learnt about the changed status of the product when they received these letters.

> *"We still have 4 years to go and we recently, funnily enough, only 3 or 4 months ago got a letter from [the product issuer] making us an offer to do, redeem and payout the loan or do nothing or participate in another fund and transfer everything over to another one. We chose to do nothing – where it sits in all the paperwork, it is not sitting in a very strong financial position. And we decided it was better for us to stay in it."* (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

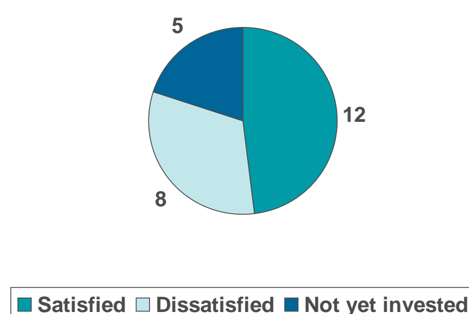
Several investors had not understood the communications they received after the investment had gone into cash-lock. They still spoke of the investment in a way that suggested that they thought it might recover. In truth, the investor above will have to pay a significant amount of interest payments each year just to *"do nothing".*

Satisfaction with the investment

Levels of satisfaction

This section summarises current and past investors' levels of satisfaction with their product. Twelve investors stated that they were satisfied with their capital protected or capital guaranteed investment.

Figure 11: Satisfaction with the investment



Of the 12 satisfied investors, most were current investors who had invested just in the last few years. They believed, for example, that they had invested at a good time and that a capital protected product was ideal in such a volatile market.

Some satisfied investors had investments which had matured well before the GFC (or they had redeemed them before the GFC). These investors had achieved significant gains.

> *"That one made 3 and a half times."* (Current investor. Various products. Not retired. Direct.)

> *"We doubled our money."* (Past investor. Various bond plus call products. Retired. Direct)

Investments that matured during or after the GFC not surprisingly did not yield the return that investors had hoped for. Most investors accepted this, however, as a function of the economy rather than a problem with the product.

However, as shown in the pie chart above, eight investors were dissatisfied. There were four main reasons for dissatisfaction.

Suspended investments

Several investors had their investment "*suspended*" or converted to cash (or 'zero coupon bonds') by the issuer during the GFC. None of these investors had expected this to happen.

> *"All the shareholders got a letter telling us that investment had been suspended due to the financial crisis."* (Current investor. CPPI product with optional borrowing. Not retired. Direct)

When the researchers used web conferencing software to show participants some documentation on the product features, the people whose investment had been suspended claimed not to have seen that information before. Some also did not understand what was written.

> *"As far as it was sold to me it was just shares … no idea what zero coupon bonds means – don't recall mention of leverage – none of this was explained to us at all."* (Current investor. CPPI product with compulsory borrowing. Not retired. Direct)

One investor explained that the investment had increased above her original capital but it was no longer increasing because it had been converted to cash. She fears that when fees are taken out and the effect of inflation is taken into account, there will be little investment gain.

Another was given the option to exit the investment, but couldn't afford to take it.

> *"Something we found to be a little frustrating is I know it had been performing quite poorly but they changed the whole investing thing where some people could buy out a certain percentage but if you didn't have $6k up front you couldn't buy out so they give you a partial redemption ... but because we didn't have enough money and we were already servicing the loan, we didn't have enough on top of that to pay what was about 2 years' worth of loan interest payment on top of the normal interest payment to cash out part of the redemption.*
>
> *So almost like they are saying we know it sucks, this is doing really badly and we know but if you have even more money to throw at us we will give you back some of your money because it is doing so badly. But for the rest of you particularly long waiting until the time you can take it out. We were already losing money, how much more did they want us to pay in fees and it was going absolutely nowhere."* (Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

Some of these investors did not understand what was actually happening. They had received letters suggesting that they redeem their investment early, or leave it where it is in cash, or start a new investment. Some investors we spoke to did not realise that there was no further possibility of gain from this investment.

Those who were most affected by 'cash-lock' were the investors who had borrowed to invest, because they had to keep paying interest payments even though the investment would not increase in value. One family for example had seen the notional value of their investment fall from $100,000 (starting amount, financed by a 100% loan) to $73,000. They were committed to paying $8,000 a year in interest for this $100,000 loan for the next 4–5 years. At the end of the investment term (maturity) they will not be required to repay the principal amount of the loan, but they will not receive any return or profit (their net loss will be the interest and fees paid, less any tax deductions claimed). If they want to exit the arrangement early, break costs and other fees would apply, as well as repayment of some or all of the original loan amount. (Current investor. CPPI product with compulsory borrowing. Not retired. Direct)

Interest rates reducing the gain

Some investors were dissatisfied with the investment because their gearing costs cut too far into the investment return.

> *"When it was sold to us we were told we would pay less interest on the investment than we would make … having said that we are actually making less than the interest is costing us. By the initial bit he was talking we should take out about $60k profit or something like that we are not going to get any profit." (*Current investor. CPPI product with optional borrowing. Not retired. Has adviser)

Fees reducing the gain

We asked investors about the fees they were paying on their investment. All believed that there would be some fees *"somewhere"*. Most answered that the fees would come out of the return rather than be payable on an ongoing basis. At the time they were happy with this.

"The fund manager would have to take some risks in investing in order to get a decent return and I would imagine therefore that ... the fee percentage would need to be higher to compensate for taking that risk while still guaranteeing the capital." (Potential investor. Bond plus call product. Not retired. Has adviser)

However, some investors whose products had matured said they had not received the investment performance they expected because of the impact of fees.

Few investors had calculated the potential impact of fees at the outset of on their investment.

Changed circumstances

Some investors regretted committing themselves to a long-term investment. At the time, for example, one investor considered the commitment to pay the interest on the loan over 7 years to be achievable. However she has since married and bought a house and has found the repayments hard to manage. *"I had lots of cash flow when I started out,"* she said. She tried to get out of her investment early, with no success.

Summary

"I have been thinking of these investments in fairly simplistic terms, if I invest $50K then the worst I can get back is $50K is really all I thought about these." (Potential investor. Bond plus call product. Not retired. Has adviser)

The quote above captures the main theme of the study. Many investors in capital protected and capital guaranteed investments have thought of these investments in simple terms.

Capital protected and guaranteed investments have appealed to novice and experienced investors at various life stages. Some have been aggressive investors who were aware that these products used futures and options and the like to achieve their results.

Others were much less aggressive in their approach and much less aware of the style of investments used. Instead they had relied on the products for their capital protection and had placed their faith in the brand name of the banks and product issuers.

Most understood 'protection' to be the same as 'guarantee'. Investors were not aware of all of the conditions on the protection. Though many knew about that they needed to invest until maturity, some of them were unaware of how much the costs would be if they withdrew early. No one seemed to know that some of these products could be 'cash-locked' until it happened to them. A few were aware that the cost of the protection or guarantee could limit the gains of the investment.

Investors have chosen these investments after a fairly cursory process in which they looked at some but not all of the information provided by the issuers. Arguably, that information is too complex and voluminous for novice or cautious investors to understand. Most have placed their faith in the issuer (if it was a bank) or the guarantor (if it was a bank) to repay investors' capital, in the event that the underlying investment made a loss.

Investors who have invested directly have had to rely on quite difficult documentation – often online – which they admit to not fully understanding. Some investors who went through financial advisers were aware of how these products work. Other advisers, however, appear to have not explained the product adequately.

Appendix

Three case studies

Current investor in an internally geared structured product

This participant invested in an ‘internally geared’ structured product in 2010, after learning about it at an options trading seminar. He was new to investing and considered himself an aggressive investor. He did not have a financial adviser.

His understanding of capital protection in this product was that “for a small fee up front (the capital that you invest), you won’t be liable for anything more than the capital that you invest ... if the share market drops by below the amount that you invested you don’t have to pay out the additional loss ... capital protection is like insurance for your investment.”

He further elaborated on what he saw as the difference between a capital guarantee and capital protection. “Capital guarantee would be you are sure to get your capital back. Capital guarantee means you will definitely get your capital back which is the amount that you invested, where protection it is protected from being reduced to below the value you started off with.”

On seeing disclosure material for the product during the research interview, the investor was surprised to read that there is the potential to lose money at maturity due to ‘hedging and external factors’ and that if he withdrew early additional fees would apply.

“I was under the impression that your $1 at the beginning was still $1 at the end, but having read your document, I think it wasn’t clear to me that the $1 at the beginning may not be $1 at the end and you may lose money as a result,” he said.

After the initial seminar, the investor read about the product on the promoter’s website, before going to another seminar. The presenter used charts and graphs to show the potential growth in the product’s reference assets, and explained the product’s fees. He also “described how the capital guarantee was backed by [a separate bank, which issued the product] and how confident they were in the [bank] to uphold their lending. And he handed out a booklet with some flyers in it.”

The investor said he read the PDS, which was about 100 pages long. He says he went through all of it and found it to be “on the difficult side”. He says he spent one or two hours a day sitting down reading it and thinking about it. He did not compare other products.

His main motivation to invest was the potential for big returns: “... to make more money, in a short time frame, without having to risk too much of my own money as well.” Tax was not a factor in his decision.

He saw the risk as having to wait a year for the coupon payment, and waiting several years until maturity for the rest of the return, after paying a lump sum of money up-front. He understood that he may not get any return at all and accepted the risk of losing everything because of the promise of gain. He understood his interest payments were not protected.

When asked about the use of derivatives, the investor said he was “not confident in what it means, I think it means something which is related to shares but is not directly shares like options, futures.”

He said that he was currently satisfied with the investment because the first coupon had been paid. He noted that the seminar presenter suggested that people could also invest their super in the same products. The participant found this appealing “because I am not all that happy with my super fund performance and this capital guaranteed method ... could make me more money in less time”.

Current investor in a CPPI product with optional borrowing

This participant decided to invest to increase his family's wealth, as he and his wife had dependent children and few savings or investments. He entered the product on advice of a financial adviser.

He understood capital protection to mean the product issuer protects "the capital you put in" so that "you can't come out with a loss or a huge loss". While he believed the money he invested could not be lost ("you can't lose the money that you put in"), any additional returns were "not guaranteed".

However, he describes the investment as a disaster. He explained how the product had an eight year maturity and involved a margin loan which was floated on the stock market, and that the investors paid for put options "so if things went pear shaped it would be put in the bank," protecting him from share market fluctuations.

However, he didn't realise that money he put into the product was not protected. "We were told at the very least you will get your money back regardless, but that wasn't the truth. The truth was the money will go back to the bank and they will get their money back, we get a big fat nothing." He said half a million dollars return had been anticipated by the adviser, but he expected to lose $64,000 plus the cost of put options.

The participant regretted not reading the PDS in full, and for the advice he received. "Our financial planner came to us. We wanted to invest in property but we didn't have enough cash to do that and this was the next best thing and it was sold like a win-win. He didn't read enough of the fine print quite clearly".

The participant described how the product performed when the market turned down. "It was chugging along at a reasonable growth as anticipated until the GFC and that is when it crashed," he said. "I thought there would be ups and downs but I always wanted some sort of protection in there for the lower times."

He says the investment was sold as "just shares". He didn't recall or know the meaning of terms such as zero coupon bonds, leverage or derivatives. "None of this was explained to us at all, it was explained to us at the very worst we would get our money back but the misunderstanding was ... you will get your money back to pay your margin loan so you won't have a debt. Whereas our interpretation was we will get our money that we personally invested each year back."

Communications from the product issuer were unhelpful. "It was the most unclear statement we have ever read … we couldn't tell how much money we were making ... and it wasn't at all clear where we were at. At the end of the financial year we would just get a whole lot of blur."

The adviser tried to transfer the participant into a 'recovery' product, which he declined to take up. The issuer also encouraged the investor to pay an exit fee, but he didn't have enough money to exit.

He says the potential poor performance was not explained. "The worst case scenario was we will get our money back, and we did discuss the worst case, but it was never as bad as what it ended up being."

"I would only recommend these products to people who need tax return factor," he concludes. "Apparently 80% of this product is tax deductible that was another sales point."

Past and current investor in 'bond plus call' products

This participant had invested directly (without advice) in a number of 'bond plus call' products. She was retired when interviewed, but had invested while she was still working. She described herself as an experienced share investor who was looking for diversification.

She described 'capital protection' as meaning that "if you invest a certain amount of dollars you expect to at least get that amount back again. The amount of protection should go up as the investment increases the capital or the bank deposit increases as well. It does guarantee you that if something happens that you would get that money from the bank."

She said that capital guarantee had the same meaning as capital protected – "capital guarantee means that the amount of money invested is guaranteed to be secure," she said.

The investor reported that her investments in these products were successful, doubling her money in one case. Meanwhile "if something had fallen over, you would still have received that money back," she said. She noted that the returns can be reduced "because they have to put some money into the guarantee".

The investor had used the product promoter's website for information and always read the disclosure document, which was originally sent by her stockbroker.

His motivation in choosing a recent product was that it offered "the potential to earn a reasonable return as well as a guarantee for our investment". She said there were no fees.

The participant said that the product issuer "doesn't usually give you any indication of what they are actually investing in, but they do indicate how the funds operating, you do get a quarterly review which gives a lot more information ... and you can check the website for their monthly [performance], just to see how the fund is going".

She seemed satisfied with the investments generally, but felt the time frames until maturity were a bit long.

She saw the risks as "probably no different to any other investment. It is still possible that [the investments] could go down, but when it was set up, even from the start, they set it up with a guarantee on the fund. It means that initially you might find that they are down, but as you stick it out through the first couple of years, then the guarantee is set."

The participant didn't know what derivatives were or whether they were used in her investments. "I have a vague idea, but I don't really look at those sorts of things," she said.

She said the performance updates on the issuer's website were helpful, as were as meetings with the company which provided indications of how the investments were going, and "the current investment scene worldwide". "You were kept well educated on the investment," she said.

Some notes on the methodology

This study used qualitative research methods to meet the exploratory nature of the objectives. We cannot guarantee that the people who took part in this study are representative of the overall population.

When using the research results, be aware of a number of limitations in the approach.

- **Sample size**. The sample for the study was small so caution should be exercised when attempting to generalise these findings to the overall population.
- **Sample bias**. Our sample may be biased towards people with internet access. Roy Morgan Single Source indicated in 2009 that 87.5% of Australians aged 18 and over have ever accessed the internet. This proportion was lower among Australians aged 65 and over, and those from lower socioeconomic groups. [1]
- **Poor recall**. In the interviews we discussed events which occurred several years ago in some instances. Some respondents were unable to recall all details accurately.
- **Hindsight bias**. People view the past subjectively when being interviewed after the fact, which may lead them to judge events differently now than they did in the past. Also, some people might think differently now because new information has come to light.

Other details

Q & A Market Research looked after the management of the Survey Village stage of the process. Megan Price subcontracted to Susan Bell Research for this project.

Storage of project documents followed best practice privacy guidelines: tapes, notes and transcripts were de-identified. Tapes and transcripts were stored separately; and separately from respondent contact information.

We informed respondents at the outset that the research was for ASIC. We asked the respondent's permission for the client to listen in. We audio-recorded all but two of the interviews. Respondents gave their permission to be recorded. We assured them that the information in the transcript and report would be de-identified. Interview tapes and transcripts were de-identified and stored separately from identifying material

[1] Roy Morgan Research (Jan–Dec 2009)