

# What Every Investor Should Know About Structured Products

Structured products are essentially combinations of notes and options linked to the value of a “reference asset,” such as a stock, an index of stocks, currencies, or interest rates. They are sold as investments that pay higher returns without exposing the investor to commensurately higher risk. A pitch like that is attractive to many investors who are frustrated by the low yield on traditionally safe investments like certificates of deposit and money market funds, but are unable or unwilling to tolerate the volatility of the stock market. Contrary to the sales pitches, however, structured products present a range of problems and risks.

The problems and risks associated with structured products include:

- A 2011 SEC staff report concluded that structured products “are often quite complex and can present wide-ranging risks and regulatory issues, including suitability and disclosure concerns, limited liquidity, comparatively opaque and often expensive fee structures, paucity of secondary market activity, and difficulty in pricing.”
- The Financial Industry Regulatory Authority (FINRA) has warned investors: “While these products often have reassuring names that include some variant of ‘principal protection,’ ‘capital guarantee,’ ‘absolute return,’ ‘minimum return’ or similar terms, they are not risk-free.”
- Structured product experts have been very critical of the sale of these products to retail investors:  
*“These notes flunk the suitability and appropriateness test for retail investors. They also flunk the test for most investment managers, investment advisors and pension fund managers. Retail investors may find that the managers who are supposed to protect their interests are in fact collecting fees and turn a blind eye to the risks.”*  
*-Janet Tavakoli,  
Consultant and Author on Structured Finance*
- Investors do not own the reference asset and have no right to the dividends or price appreciation of the reference asset.
- The payout of structured products is driven by derivatives making them too risky for most investors.
- Structured products are unsecured obligation of the issuer. If the issuer defaults, investors can lose their entire investment.
- Structured products burden the investor with high fees and expenses, which erode returns.
- Structured products are illiquid investments. There is usually little or no secondary market and the issuer is not required to buy them back if the investor needs to cash out. Further, many structured products impose lock-up periods that prevent investors from cashing out even if a buyer can be found.
- Structured products are generally over priced. Because they are so opaque and complex, however, no ordinary broker or investor can determine what the correct price should be.
- Because brokers are typically do not understand how structured products work and what the risks are, they cannot explain the risks to their customers.

*“In my three decades of Wall Street experience, I have not seen any other products as absurdly destructive as retail investments linked to structured products. Deservingly, the architects and marketers of these bizarre investments are facing a long-term battle with investors rage and regulatory scrutiny.”*

*-Louis Straney,  
Securities Arbitration Consultant*



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