

# Do structured products lack transparency?

Before buying a financial product, all investors should make sure that they are familiar with the basic features and functioning of the product they are interested in. This requires the product to be transparent. Objective criteria can be used to ascertain whether or not a product is transparent. Investors who perform such a test on structured products or other financial products may well be in for a surprise.

## Facts

In financial theory, it is possible to distinguish between six forms of transparency for financial products: transparency of the underlying, scenario transparency, risk transparency, cost transparency, liquidity transparency, and valuation transparency. In this context, it is particularly important to answer the following questions: What is the product’s underlying? What conditions are attached to the returns? Are the risks clearly specified, and are there appropriate risk indicators? What are the costs involved? Can investors choose to sell the product at any time without difficulty? Can investors track the current value of the product at all times? In addition, transparency also requires that information is available concerning the structure and the development of the market in question. In answer to these questions, the following facts demonstrate that structured products have extremely high product and market transparency. They even perform better than many other established financial products.

## Product transparency

It is important for investors to know the underlying on which a financial product is based. The **transparency** of these **underlyings** is high if the individual components of the financial product are known and available to the public at all times. A structured product’s performance is always linked to that of an underlying. These underlyings can be, for example, equities, indices, commodities or currencies. All structured product investors are aware of the underlying of their instrument, as it is the product’s most important feature.

If a product’s performance in relation to various developments and scenarios of the underlying in question is shown even before the product is purchased, this indicates **scenario transparency**. In the case of structured products, investors know what payout they can expect from the very outset, depending on the development of the underlying. The Key Information Documents present the potential returns and risks of products in a transparent manner.

### Transparency of financial products: a comparison

Transparency in relation to ...	Underlying	Scenario	Risk	Costs	Valuation	Liquidity
Open-end funds (with active management)	0	-	++	+	+	++
Exchange Traded Funds (ETFs)	++	++	++	+	++	++
Structured products	++	++	++	+	++	++
Life insurance	--	0	0	+	-	-

++ very high    + high    0 average    - low    -- very low



## Facts and Figures

If all risks of a financial product and their magnitude have been described and the corresponding calculation methods are available, this indicates **risk transparency**. Here a distinction must be made between the credit risk and the market risk.

Structured products are bearer debt instruments and so, like bonds, they are subject to **credit risk**. Issuers of structured products therefore have their creditworthiness or credit rating regularly assessed by rating agencies. Credit Default Swaps (CDSs) also help investors to correctly assess the creditworthiness of a particular issuer. The lower the figure, the higher the creditworthiness. The DDV publishes the current CDSs of issuers every trading day on its website at [www.derivateverband.de](http://www.derivateverband.de).

Investors can easily assess the **market risk** for nearly all structured products. The Summary Risk Indicator in the Key Information Document categorises all investment and leverage products into one of seven risk classes, ranging from security-oriented to speculative. Both market risk and credit risk are used in the Summary Risk Indicator calculations.

The criterion of **cost transparency** has been met if the individual cost components are clearly indicated and the levels of these costs are made known. Issuers disclose the product costs for structured products in the legally prescribed Key Information Documents and product information sheets. In accordance with the revised European Markets in Financial Instruments Directive, these costs comprise the entry charges, the ongoing charges, and the exit charges. The product costs include the operational costs incurred by the issuer for structuring, market making and settlement of the respective structured product, and also contain the expected profit for the issuer.

There is **valuation transparency** if the value of the financial product is known at all times. The buy and sell prices of structured products are updated and published every hour at the stock exchanges in Stuttgart and Frankfurt. For over-the-counter trading, issuers also provide a continuous stream of buy and sell prices for tradable products.

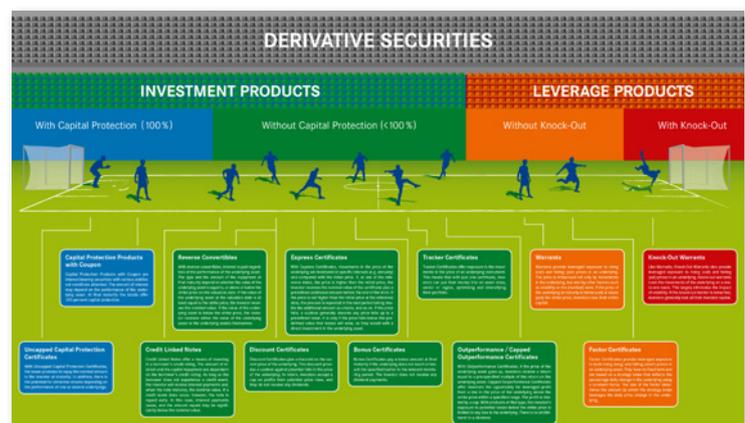
Investors have **liquidity transparency** if the possibility, speed and costs of buying and selling a financial product are described and quantified.

Investors can find the most important information on these six transparency criteria on the websites of structured product issuers and stock exchanges, and on many financial portals.

## Market transparency

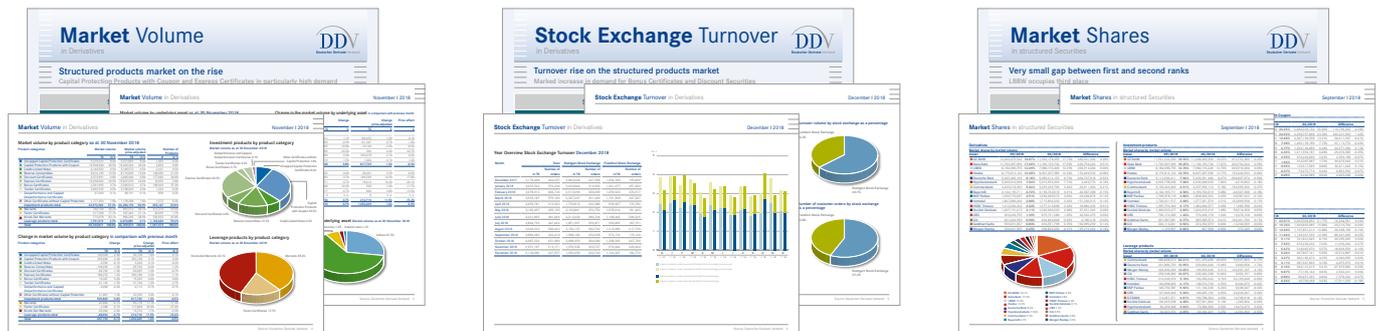
In addition to the transparency of the financial products, the transparency of the market in question is important for investors. In this regard the DDV, together with its members and sponsoring members, has set important standards.

**Product classification:** An essential prerequisite for transparency is the DDV's product classification system, which all German issuers use as a yardstick. It provides structure to the wide range of investment and leverage products. This Derivatives League compares the most important product categories to the eleven positions that make up a football team. The different types of products can mainly be differentiated in terms of the way they function and the degree of risk they involve.



# Facts and Figures

**Standardised terminology:** The DDV has also set an important market standard in defining and stipulating the terminology needed to explain structured products and the way they function. This has been adopted by the members of the DDV and also by the stock exchanges in Stuttgart and Frankfurt.



**Market statistics:** The DDV regularly publishes very detailed statistics on market volumes, stock exchange turnovers and market shares.

## Orientation guide for investors

### Key information documents

Since the start of 2018, all potential investors have had to be provided with a Key Information Document prior to purchasing a packaged investment product. In principle, this document applies to structured products and insurance-based investment products, and will also start to apply to investment funds from 2020. The Key Information Document presents the key features and functioning of a financial product on three pages, describes in detail the associated risks and benefits of the product in various scenarios, and also lists the product costs. The Summary Risk Indicator provides a clear presentation of the risks of the investment using seven risk classes. The Key Information Document is also intended to facilitate comparison between different financial products.



### Investment checklist

In cooperation with Deutsche Schutzvereinigung für Wertpapierbesitz (DSW), Germany's oldest and largest association for private investors, the DDV has drawn up a checklist encompassing 18 questions and answers that investors can use to check the most important points before buying a structured product. The checklist provides a good overview of information that investors should obtain before deciding to buy a structured product. In addition, investors can check whether they really know the conditions attached to the structured product of their choice and whether they have understood all the important points.

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